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Forex Trading



**3 Proven
Strategies You Can
Start Using Today**

By Jon McFarlane

Forex Trading

3 Proven Strategies

You Can Start

Using Today

By Jon McFarlane

Co-Authors; Nigel Price and “Forex” John

<http://forexuseful.com/>

DISCLAIMER

Trading any financial market involves a high level of risk and may not be suitable for everyone. You should only trade with money you can afford to lose.

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About

The Author

This book has been written by me, **Jon McFarlane**. I have been successfully investing and trading my own money on a full or part-time basis for over 20 years.

In 2008 I set up [Systems For Traders](#), an independent review site for trading related products.



100% Independent & Honest Reviews of Trading Systems and Services

The aim was to, in my spare time, based on my experience, help those new to trading avoid the many useless products being peddled across the industry. With over 120 reviews of, in the main, useless, Trading systems and Signal services, I concluded that a change in direction was needed.

With a new focus, to provide quality trading related courses and resources,

together with other qualified traders, in 2013, I founded **Forex Useful**. Two of those traders, who I have great respect for and am entirely grateful to know, **Nigel Price** and **“Forex” John**, are co-authors of this book.

All Forex Useful authors are real traders who trade on a full or part time basis and can be contacted directly via the Forex Useful website.

Our **FREE** strategies (detailed in this book) have been downloaded over 10,000 times by traders across the entire globe.

This Book

Due to many requests from Forex Useful members and rather than publish 3 separate books, this book is a consolidation of the 3 FREE Trading strategies currently available on the Forex Useful website:

- **The 3 Little Pigs Trading Strategy, by Jon McFarlane**
- **The Price Action Swing Trading (PAST) Strategy by Nigel Price**
- **Trading With Confluence – The Foundations by “Forex” John**

The 3 Little Pigs Trading Strategy is a

trend following swing trading strategy based on Multiple Time Frame (MTF) analysis. By using the Weekly, Daily and 4 Hour time frames it is completely possible to apply the 3 Little Pigs Trading Strategy across many markets in less than 10 minutes a day. ***The 3 Little Pigs is a former winner of the BabyPips Best FREE Forex Trading System of the month!***

The Price Action Swing Trading (PAST) Strategy is designed to give you a clear set of guidelines that can be used to make sure your winning trades are bigger than your losing ones. It uses candlestick reversal signals on the longer “anchor” time-frame charts and

then trend line breaks on the lower time-frame charts to make precision entries.

Improve your Forex future, learn to trade the PAST!

Trading With Confluence is about taking sound trading foundations and bringing them all together. The ‘Analysis’ foundations provide a real time view of the market. When combined with the ‘Trigger’ and ‘Awareness’ foundations a technical outlook of the market is formed. The result is a Trading plan with clearly defined high probability trading opportunities. ***Confluence: A gathering, flowing, or meeting together at one juncture or point***



I hope you enjoy this book and I welcome you to visit **Forex Useful**
(**<http://forexuseful.com/>**)

As a member (**it's completely FREE**) you will be able to download and print the 3 strategies in this book and you will also have access to:

- **Via our newsletter, FREE weekly**

**updates on all the strategies in
this book**

- **FREE Live market sessions
(usually every Monday morning)**



**As well as access to
the products, updates
and sessions you will
also be informed of
future book releases
including launch and
discount offers, before
anyone else!**

To understand and implement the strategies defined in this book obviously requires at least some basic knowledge of Forex and Currency Trading. Those new or even relatively new to trading may find my book **Forex For Beginners – An Illustrated Introduction To Currency Trading** of interest.

Those of you considering trading Binary Options you may also find my other book **Binary Options – A Strategy Guaranteed To Beat The Brokers In 15 Minutes Flat**, of interest.

I really hope you enjoy this book and if you do then please do take the time to leave a review, it takes less than a minute and your feedback is personally

appreciated by me.

Jon McFarlane

Forex Useful

(<http://forexuseful.com/>)

The 3 Little Pigs Trading Strategy

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**THE 3 LITTLE PIGS
TRADING STRATEGY**



By

Jon McFarlane

Introduction

The 3 Little Pigs Trading Strategy is a trend following swing trading strategy based on Multiple Time Frame (MTF) analysis.

By using the Weekly, Daily and 4 Hour time frames it is completely possible to apply the 3 Little Pigs Trading Strategy across many markets in less than 10 minutes a day.

I use it to trade the Forex markets but in theory it can be applied to any financial market.

The 3 Little Pigs is a former winner of the BabyPips Best FREE Forex

Trading System of the month!

In The Fairy Tale...

The 1st Little Pig



Used common sense
He wanted to protect himself from the
wolf

And he wanted to do it quickly and
easily

He built his house from straw

The 2nd Little Pig



Used common sense and logic

He also wanted to protect himself from
the wolf

But he needed something stronger than
straw

He built his house from sticks

The 3rd Little Pig



Used common sense, logic and

experience

He also wanted to protect himself from
the wolf

But he needed something stronger than
Straw & sticks

He built his house from bricks

When Trading...

The 1st Little Pig



Uses common sense
To trade in the direction
Of the Long term trend by
Observing Price action on the Weekly
chart

The 2nd Little Pig



Uses common sense and logic
To trade in the direction

Of the Long & Medium term trends by
Also observing Price action on the Daily
chart

The 3rd Little Pig



Uses common sense, logic and
experience

To trade in the direction
Of the Long, Medium & Short term
trends by
Using Price action on the 4 Hour chart
for Entry

Basic Principles – Part 1

The 3 Little Pigs is a:

Trend Following



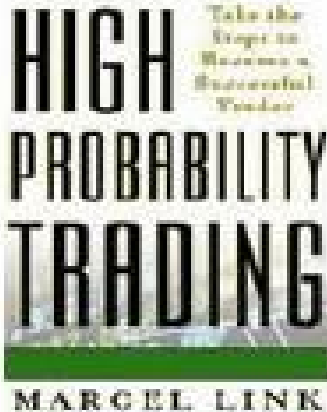
Swing Trading strategy



Based on Multiple Time Frame (MTF)
trading



Multiple Time Frame (MTF) trading was made popular by Marcel Link in his excellent book titled “High Probability Trading”:



HIGH PROBABILITY TRADING

Take the
Steps to
Becoming a
Successful
Trader

MARCEL LINK

The 3 Little Pigs has taken the MTF trading concept and added sound trading principles to establish a solid strategy that can, in theory, be applied to any financial market.

Basic Principles – Part 2

**The 3 Little Pigs is based on
3 time frames**

**The 1st Little Pig uses
A Red SMA(55) on the Weekly time
frame**



To trade in the direction of the Long term trend based on the Average Closing price during the **LAST YEAR**

Long when price closes above the Red

SMA(55)

Short when price closes below the Red

SMA(55)

The 2nd Little Pig uses An Amber SMA(21) on the Daily time frame



To trade in the direction of the
Long and Medium term trends based on

the Average Closing price during the
LAST MONTH

Long when price closes above the
Amber SMA(21)

Short when price closes below the
Amber SMA(21)

The 3rd Little Pig uses A Green SMA(34) on the 4 Hour time frame



To enter a trade in the direction of the

Long, Medium and Short term trends
based on the Average Closing price
during the **LAST WEEK**

Long when price closes above the Green
SMA(34)

Short when price closes below the
Green SMA(34)

The direction of the trend on each time
frame is based on Price relative to a
specific Simple Moving Average
(SMA).

The Simple Moving Average

The Moving Average is an industry standard indicator and there are many variations; Simple, Exponential, Smooth, Weighted, to name but a few.



Moving Averages reflect
The Average Closing price of a Market
Over a specific Number of periods

For the purposes of The 3 Little Pigs
AND to keep things simple:

The Simple Moving Average is used

**The Simple Moving Average is
commonly referred to as the SMA**

**SMA is commonly written as SMA
(*Number of periods*)**

This example has been taken from the
Daily GBPUSD chart in 2012. The
SMA(5) has been manually calculated to
show how it works – The SMA(5)
shows, each day, the Average Closing
price for GBPUSD during the last 5
periods (Days).

Date	Closing Price	SMA(5)
Wed 12-Sep	15108	
Thurs 13-Sep	16150	
Fri 14-Sep	16214	
Sun 16-Sep	16221	
Mon 18-Sep	16247	16188
Tues 19-Sep	16239	16214
Wed 20-Sep	16220	16228
Thurs 21-Sep	16214	16228
Fri 22-Sep	16228	16229

AND...

Here it is on the chart



The SMA(5) is shown as a Black Line
Automatically calculated and displayed
By the Charting package

Why 55, 21 And 34?

The Fibonacci sequence (of numbers)



The Fibonacci sequence (of numbers) is frequently observed in nature and is

commonly referenced in the world of trading.

The *Number of periods* for each SMA used by The 3 Little Pigs is derived from the Fibonacci sequence.

The 1st Little Pig uses A Red SMA(55) on the Weekly time frame



This reflects the Average Closing Price

During the LAST YEAR – Give or take
a week or two

The LONG TERM TREND can be
considered:

- UP if price closes above the Red
SMA(55)
- DOWN if price closes above the
Red SMA(55)

The 2nd Little Pig uses An Amber SMA(21) on the Daily time frame



This reflects the Average Closing Price

During the LAST MONTH – Give or
take a day or two
The MEDIUM TERM TREND can be
considered:

- UP if price closes above the Amber
SMA(21)
- DOWN if price closes below the
Amber SMA(21)

The 3rd Little Pig uses A Green SMA(34) on the 4 Hour time frame



This reflects the Average Closing Price

During the LAST WEEK – Give or take
an hour or two

The SHORT TERM TREND can be
considered:

- UP if price closes above the Green
SMA(34)
- DOWN if price closes below the
Green SMA(34)

Buying Strategy – The 1st Little Pig

**The 1st Little Pig MUST confirm that
The LONG TERM TREND is UP**

GBPUSD5B Weekly 1.62447 1.62665 1.61367 1.61984

LONG TERM TREND is UP
Price has closed above the Red SMA(55)

Last Confirmation
Weekly candle
Close
19-08-2012

LONG TERM TREND is NO LONGER UP
Price has closed below the Red SMA(55)



Price must have closed above its
Average Closing price during the **LAST**
YEAR

It must have closed above the Red
SMA(55) on the Weekly time frame To
confirm that:

The LONG TERM TREND is UP

Buying Strategy – The 2nd Little Pig

**The 2nd Little Pig MUST confirm that
The MEDIUM TERM TREND is also
UP**

LONG TERM TREND is UP
Price has closed above the Red SMA(55)

Last Confirmation
Weeklycandle
Close
19-08-2012

LONG TERM TREND is NO LONGER UP
Price has closed below the Red SMA(55)



Price must have closed above its
Average Closing price during the **LAST**
MONTH

It must have closed above the Amber
SMA(21) on the Daily time frame To
confirm that:

The MEDIUM TERM TREND is also
UP

Buying Strategy – Confirmation

**The LONG TERM TREND and the
MEDIUM TERM TREND**

**Must BOTH be UP before looking for
Buying opportunities**

In this example the LONG TERM TREND was confirmed as being UP when the Weekly candle 19-08-2012 closed – Weekly candles typically open on a Sunday and close on a Friday so it means that the first trading day after this candle closed would have been (Monday) 27-08-2012 – Marked on the 4 Hour chart that follows.



On the 27-08-2012 there was no need to wait for the MEDIUM TERM TREND to be confirmed as being UP as it was already confirmed when the Daily candle on 08-08-2012 closed.



In this example it is OK, from the 27-08-2012, when the LONG TERM TREND and the MEDIUM TERM TREND were both confirmed as UP to look for Buying opportunities – The 3rd Little Pig.

NOTE: Sometimes this is the case, the

LONG TERM TREND is confirmed after the MEDIUM TERM TREND, sometimes the MEDIUM TERM TREND confirms first (see Selling example later). It does not matter which way round the confirmation occurs just as long as both are confirmed before looking for Buying/Selling opportunities.

Buying Opportunities – The 3rd Little Pig

IMPORTANT!

**The LONG TERM TREND and the
MEDIUM TERM TREND**

Must BOTH be UP

**Before looking for Buying
opportunities**

**The 3rd Little Pig MUST confirm that
The SHORT TERM TREND is also
UP**

**Buying opportunities present on the 4
Hour chart when:**

- Price first touches (or has been below) the Green SMA(34)
- And then closes above the Green SMA(34)
(Its Average Closing price during the LAST WEEK)
- To confirm that:

**The SHORT TERM TREND is also
UP**

Monday
27-08-2012

BUYING OPPORTUNITIES
Price first touches
(or has been below)
The Green SMA(34) and then
Closes above the Green SMA(34)



Selling Strategy – The 1st Little Pig

**The 1st Little Pig MUST confirm that
The LONG TERM TREND is DOWN**

USDJPY5B Weekly 78.131 78.160 77.576 77.587

LONG TERM TREND is NO LONGER DOWN
Price has closed above the Red SMA(55)



Price must have closed below its
Average Closing price during the **LAST**
YEAR

It must have closed below the Red
SMA(55) on the Weekly time frame To
confirm that:

The LONG TERM TREND is DOWN

Selling Strategy – The 2nd Little Pig

**The 2nd Little Pig MUST confirm that
The MEDIUM TERM TREND is also
DOWN**

MEDIUM TERM TREND is NO LONGER DOWN
Price has closed above the Amber SMA(21)



MEDIUM TERM TREND is DOWN
Price has closed below the Amber SMA(21)

Last Confirmation
Daily candle
Close
19-09-2012

Price must have closed below its
Average Closing price during the **LAST**
MONTH

It must have closed below the Amber
SMA(21) on the Daily time frame To
confirm that:

The MEDIUM TERM TREND is also
DOWN

Selling Strategy – Confirmation

The LONG TERM TREND and the MEDIUM TERM TREND

**Must BOTH be DOWN before
looking for Selling opportunities**

In this example the LONG TERM TREND was confirmed as being DOWN when the Weekly candle 26-08-2012 closed – Weekly candles typically open on a Sunday and close on a Friday so it means that the first trading day after this candle closed would have been (Monday) 03-09-2012.



The LONG TERM trend was most recently confirmed as DOWN when the Daily candle on 19-09-2012 closed.



In this example it is OK, from the 20-09-2012, when the LONG TERM TREND and the MEDIUM TERM TREND were both confirmed as DOWN to look for Selling opportunities – The 3rd Little Fig.

NOTE: Sometimes this is the case, the MEDIUM TERM TREND is confirmed after the LONG TERM TREND, sometimes the LONG TERM TREND confirms first (see Buying example earlier). It does not matter which way round the confirmation occurs just as long as both are confirmed before looking for Buying/Selling opportunities.

Selling Opportunities – The 3rd Little Pig

IMPORTANT!

**The LONG TERM TREND and the
MEDIUM TERM TREND
Must BOTH be DOWN
Before looking for Selling
opportunities**

**The 3rd Little Pig MUST confirm that
The SHORT TERM TREND is also
DOWN**

**Selling opportunities present on the 4
Hour chart when:**

- **Price first touches (or has been**

above) the Green SMA(34)

- And then closes below the Green SMA(34)
(Its Average Closing price during the LAST WEEK)
- To confirm that:

**The SHORT TERM TREND is also
DOWN**

USDJPY5B,H4 77.633 77.633 77.580 77.611

Thursday
20-09-2012



SELLING OPPORTUNITIES

Price first touches
(or has been above)

The Green SMA(34) and then
Closes below the Green SMA(34)

Entries, Stops And Targets

The 3 Little Pigs Trading strategy makes the Trade identification process mechanical – It easily identifies Low Risk High Probability Buying and Selling opportunities for Swing trades in the direction of the Long, Medium and Short Term (**Yearly, Monthly and Weekly**) trends.

However - Although the Trade identification process is mechanical The 3 Little Pigs is NOT and CANNOT be 100% mechanical because...



We Are All Different



Some people have
BIG Accounts ...
Others have much
Smaller ones

Some trade
Major news ...
Others avoid it
Like the plague



Some like to take
Great risks ...
Others like to be
More conservative



Some like to keep an
Eye on their trades ...
Others simply prefer
Not to



Some have lots of time ...
Others have very little



Some traders are quite aggressive ...
Others are more conservative

Yes, it's a fact, we are all different. It means that depending on experience, circumstances and attitude to risk we will all choose different criteria to use when deciding how we manage our own Entries, Stops and Targets.

**Entry, Stop and Target management is
DISCRETIONARY...
It means YOU choose!**

Entries

Buy



**On Close
Of the Trigger candle**

Sell



Buy



**On a retracement
To the SMA(34)**

Sell



Buy



**At the High/Low
Of the Trigger candle
+/- X PIPs (optional)**

Sell



Of course these are just suggestions,
other suggestions include:

- An additional candle close
Above/Below the Trigger candle
High/Low
- An additional indicator confirms,
e.g. RSI, MACD, Stochastic...

The fact is...

**Entry management is
DISCRETIONARY...**

**It will be dependent on your personal
experience, circumstances**

**And attitude to risk
It means YOU choose!**

Stops

Buy



**Just Above/Below the
SMA(34)**

Sell



Buy



**At the High/Low
Of the Trigger candle
+/- X PIPs (optional)**

Sell



Buy



**At the most recent
Swing High/Low**

Sell



Of course these are just suggestions,
other suggestions include:

- A Fixed Stop, e.g. 50 PIPs
- An additional indicator can be used, e.g. Parabolic SAR, Bollinger band...

The fact is...

**Stop management is
DISCRETIONARY...**

**It will be dependent on your personal
experience, circumstances**

**And attitude to risk
It means YOU choose!**

Targets

Fixed



This can be:

- A set amount, e.g. 50, 100, 200 PIPs...
- Based on difference between Entry and Stop

Open / Trailing



- Above/Below the most recent Swing High/Low
- When price touches SMA(34)

- When price closes Above/Below
SMA(34)

Active



- Active management based on Price action
- Support/Resistance and/or Trend

lines

- Longer term based on the Daily time frame
- Taking half profits / Running some profits

Again, these are just suggestions, the fact is...

**Target management is
DISCRETIONARY...**

**It will be dependent on your personal
experience, circumstances**

And attitude to risk

It means YOU choose!

Money Management

This subject is often complicated but you can keep it simple with these simple rules:

- Never risk more than 2% on any one trade
- Never trade more than 5 markets at any one time
- Stick to these simple rules

Never Risk More Than 2% On Any One Trade



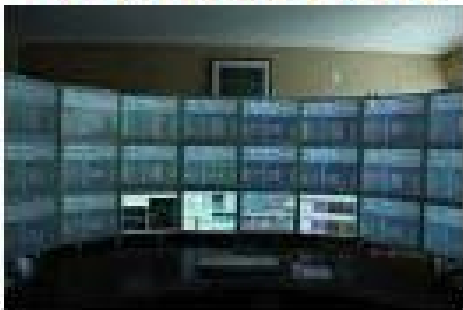
2%

This means if you have a £10,000 balance you will never risk more than £200 on any one trade. If you are placing a trade and your Stop loss is 50 PIPs away that means you will trade at £4 a PIP. If your Stop loss (which is 50 PIPs away) is hit you will lose a maximum

2% of your balance, £200 (50 PIPs multiplied by £4).

Never Trade More Than 5 Markets At Any One Time

No! No! No!



If you limit your trading to 5 markets at any one time and you “Never risk more

than 2% on any one trade” your maximum exposure in the market at any one time will be 10%. This is more than enough for even the most experienced trader.

Stick To These Simple Rules



Summary

Use The 3 Little Pigs To
Identify



- Low Risk High Probability
- Buying and Selling opportunities
- For Swing trades in the direction of
- The Long, Medium and Short term
- (Yearly, Monthly and Weekly)
trends

Entries, Stops and Targets Allow



We Are All Different



Some people have
BIG Accounts ...
Others have much
Smaller ones

Some trade
Major news ...
Others avoid it
Like the plague



Some like to take
Great risks ...
Others like to be
More conservative



Some like to keep an
Eye on their trades ...
Others simply prefer
Not to



Some have lots of time ...
Others have very little



Some traders are quite aggressive ...
Others are more conservative

- Experience,
- Circumstances and
- Attitude to risk to guide you
- Choose criteria that suits YOU

Money Management Stick To The Rules



- Never risk more than 2% on any one trade
- Never trade more than 5 markets at

any one time

- 10% maximum exposure in the market
- At any one time



Remember, as a member (it's completely FREE) of **Forex Useful** (**<http://forexuseful.com/>**), you will be able to download and print the 3 strategies in this book and you will also have access to:

- **Via our newsletter, FREE weekly updates on the 3 Little Pigs**

Trading Strategy and all other strategies in this book

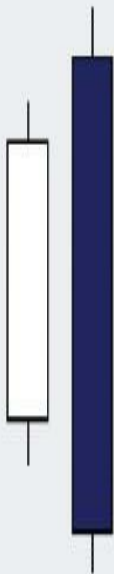
- **FREE Live market sessions (usually every Monday morning)**



As well as access to the products, updates and sessions you will also be informed of future book releases including launch and discount offers, before anyone else!

Next up, **The Price Action Swing Trading (PAST) Strategy** by Nigel Price...

The Price Action Swing Trading (PAST) Strategy



THE **PAST** STRATEGY

price action swing trading

Improve your Forex Future

Learn to Trade the PAST!

By Nigel Price

Chapter One

“It’s not whether you’re right or wrong that’s important, it’s how much money you make when you’re right and how much you lose when you’re wrong.”

- George Soros

The above quote is the foundation of the PAST Strategy. As traders, we tend to concentrate much of our energies on attempting to predict the future direction of the market. Unfortunately, our efforts to forecast future market prices on a consistent basis usually fail, no matter how experienced we might be.

As a consequence of this, we frequently find ourselves caught up in a wild goose chase of trying to find a technical charting indicator or a combination of indicators that will help us predict what price is going to do next. We mistakenly think that if we can do this, success and profits will automatically follow.

Often our progress, as new traders at least, depends on how quickly we can come to accept that we have very little real idea of what price is going to do in the future, and no amount of fancy indicators on our charts is going to change that. If you follow financial commentators and analysts you will notice that they are prone to shouting very loudly about the calls they get right

and they keep comparatively quiet about the calls they get wrong. Given that they are starting out with a one in three chance of being right in any event, (the market can only move up, down, or sideways after all) they can't help but be correct every now and again, no matter how terrible a forecaster they might be (and some are).

Put slightly differently, they make the most out of the correct predictions and limit the damage from the ones that didn't work out.

That's what we traders should be doing too. We might not be very good at predicting the future, but we don't need to be. We just need to make sure we

make as much profit as we can when we are correct and we mitigate the losses when we are wrong. That is the essence of good trading and that is what the PAST Strategy is all about.

Chapter Two

“The desire to maximise the number of winning trades (or minimise the number of losing trades) works against the trader. The success rate of trades is the least important performance statistic and may even be inversely related to performance.”

- William Eckhardt

Most readers will have encountered the phrase “risk versus reward ratio” at some stage in relation to their trading. Essentially it means the ratio between how much you are willing to lose on a given trade and the amount you are

targeting to gain.

Some people are happy to risk a few hundred pips to gain 10 or 20 pips. These traders, if profitable, will have to win most of their trades - they will have a high percentage success rate and a high risk v reward ratio. Other traders prefer to risk a smaller amount than they aim to profit - they can operate with a lower percentage success rate and still be very profitable. It is worth noting that some of the best hedge fund managers in the world have a trade success percentage rate of around 5%. Although they are wrong 95% of the time, they still make millions, if not billions, of dollars for their clients, consistently. Their winning trades are very large and their losing

trades are very small.

There is no right or wrong approach to this. Some traders do not like taking regular losses because it affects their trading emotions. Consequently, they are naturally attracted to high success percentage strategies. Others are willing to take lots of small losses, safe in the knowledge that when their winners come they will make sure that they are big. What type of trading approach to use is largely a matter for personal preference.

The PAST Strategy falls firmly into the second of the two categories above. It always tries to keep losing trades (risk) very small, and tries to allow winning trades (reward) to grow as large as

possible. Because of this approach, the strategy can sustain significantly more losing trades than winners and still return an overall profit.

How does the PAST Strategy do this? Well, of primary importance is our constant emphasis on the strict control of risk; this comes first and foremost. Then, once we have a position in the market, our concentration shifts towards finding techniques that allow it to grow as large as possible.

Chapter Three

“The fundamental law of investing is the uncertainty of the future.”

- Peter Bernstein

The PAST Strategy aims to take advantage of “swings” that take place in the markets. We attempt to get into the market somewhere near the top of a market move, as it is rolling over, and get out somewhere further down, closer to the bottom. Or vice versa for an upward market move. The swings look like this:



Although these swings take place on all market timeframes, the ones that interest us most are those that have the potential to be the biggest and run for the longest period of time. The best places to look for areas where a large potential move might be occurring are the longer term charts, such as the weekly or monthly charts. I refer to these as my “anchor” charts. Swings that occur on these large timeframes are seen as significant by large participants in the markets, like institutional traders, banks and hedge funds. These are the people that really drive market direction and so we should want to position ourselves alongside them whenever we can. On rare occasions I might look at the daily chart

for swings to develop, but certainly no lower than that.

The chart below is a weekly chart of the Australian Dollar/Swiss Franc currency pair, which has been showing some nice swings recently.



So how can we trade swings like these? Of course it is very easy to open up a price chart, scroll back and pick out nice swings that would have been very profitable to trade. Anyone can do that. The problem is how can we identify in advance where and when a new one is going to start?

Well the answer is that we don't know - no one really does. All we can do is trade in such a way so that we are positioned to profit if a new swing does occur, and to limit our losses if it doesn't.

Now it is time to analyse how we can identify where a new swing might be

beginning to emerge on a longer timeframe chart.

Chapter Four

“I believe the very best money is made at the market turns. Everyone says that you get killed trying to pick tops and bottoms and you make all your money by playing the trend in the middle. Well for twelve years I have been missing the meat in the middle but I have made a lot of money at tops and bottoms.”

- Paul Tudor Jones

In the PAST Strategy we use two very simple candlestick charting signals to indicate an area where the market might be beginning to contemplate turning

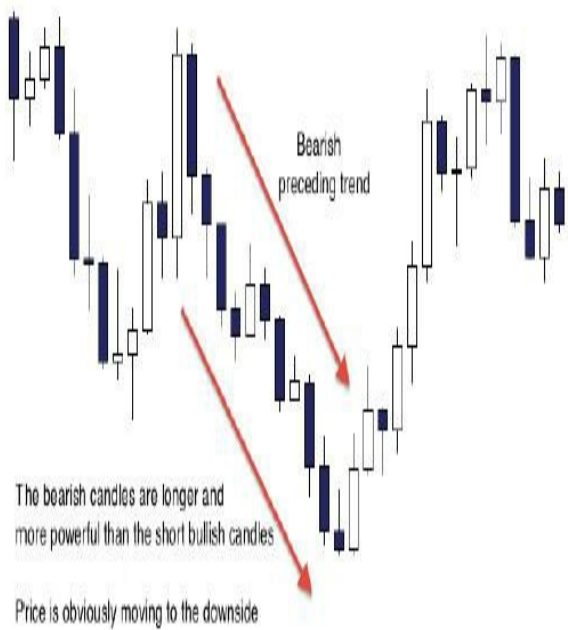
around and starting a new swing. We can refer to these as trend reversals.

But before we look at these signals, it is important to remember that in order for a trend reversal to occur, we need to have a trend in the first place. A preceding trend is easy to identify, in fact it should be obvious. If you have to look too hard for the preceding trend, it probably isn't there.

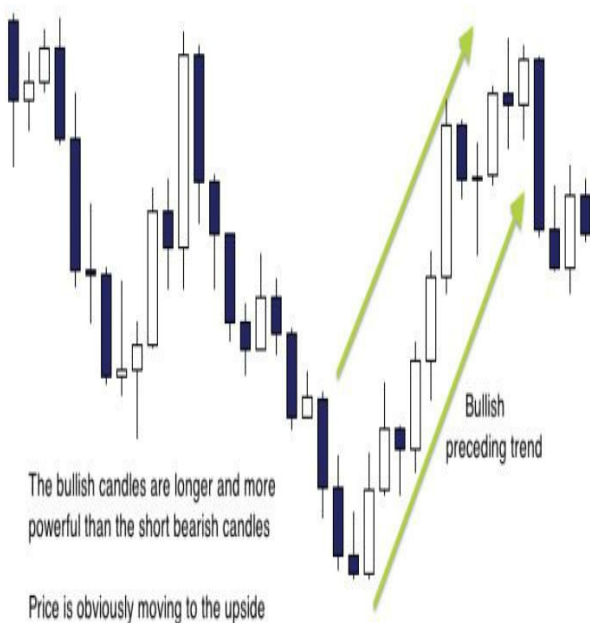
On the next page we will look at some examples of what preceding trends look like.

Here is a bearish trend. Notice that it is mainly comprised of large long bearish candles. Price is obviously

moving in a downward direction.



We can see an example of a bullish preceding trend on the same chart:



The preceding trend is important. This is

because reversals occur a bit like a ball bouncing off a wall or someone bouncing off a trampoline. The harder and faster price is moving into the reversal, the more likely it is to snap back harder and faster away from it. It is much easier to trade price that is moving nice and quickly rather than price that is moving slowly and not really going anywhere. It is not impossible to trade weak reversals, but they can sometimes be a little bit more difficult than strong ones. You'll usually need a bit more patience to trade weak reversals. If you are just starting out you would be best advised to stick with the strong reversals until you gain more experience in this style of trading. So always look for good

long candles and a nice strong preceding trend.

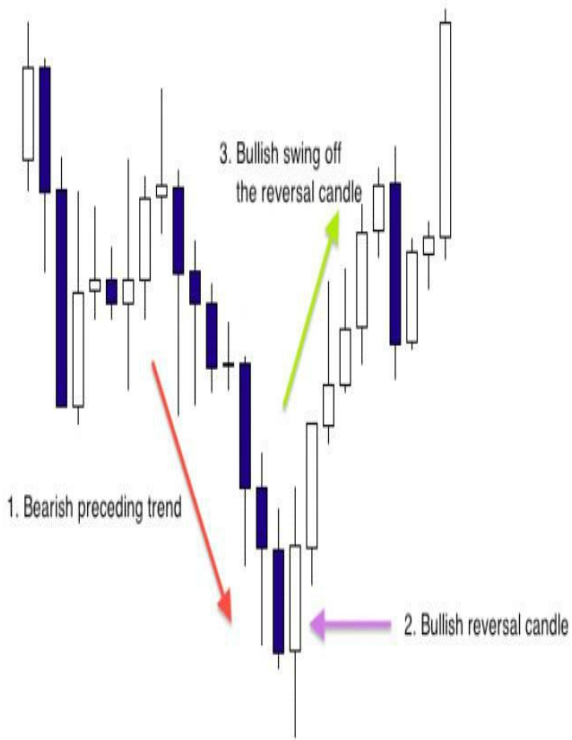
Once we have identified a good preceding trend, either bullish or bearish, we then look for clues that a reversal might be beginning to take place. We will examine what these signals look like in the next chapter.

Chapter Five

“To learn about the market, ask the market.”

- Homma Munehisa

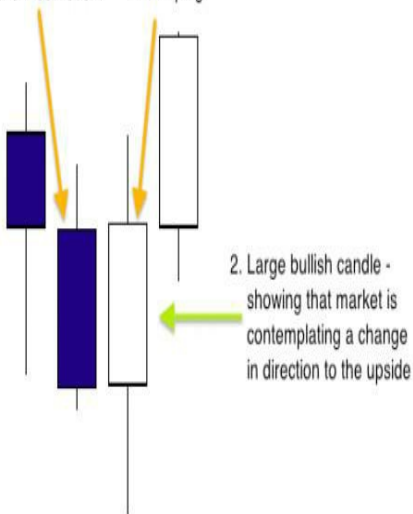
Candlestick analysis is one of the oldest, simplest and best ways to identify areas where price might be contemplating a change in direction. The first candle signal we look for is one where, in a bearish trend, a strong bullish candle appears that closes above the opening price of the most recent bear candle. This might sound complicated but it really isn't. Here is an example:



Let's look at the bullish reversal candle itself a bit more closely:

3. The closing price of the bullish candle is above the opening price of the bearish candle. This tells us that the bulls mean business and could want to push price higher. A new swing could be developing!

1. Opening price of the most recent bearish candle

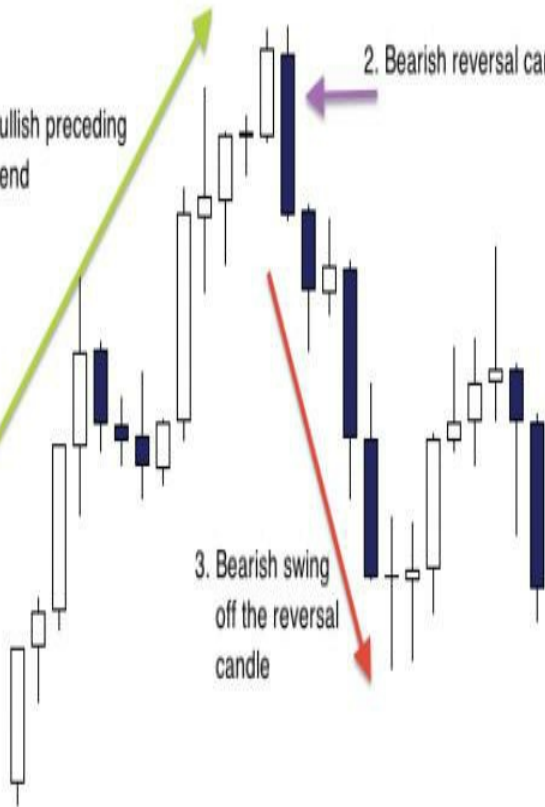


Here is an example of a bearish reversal candle:

1. Bullish preceding trend

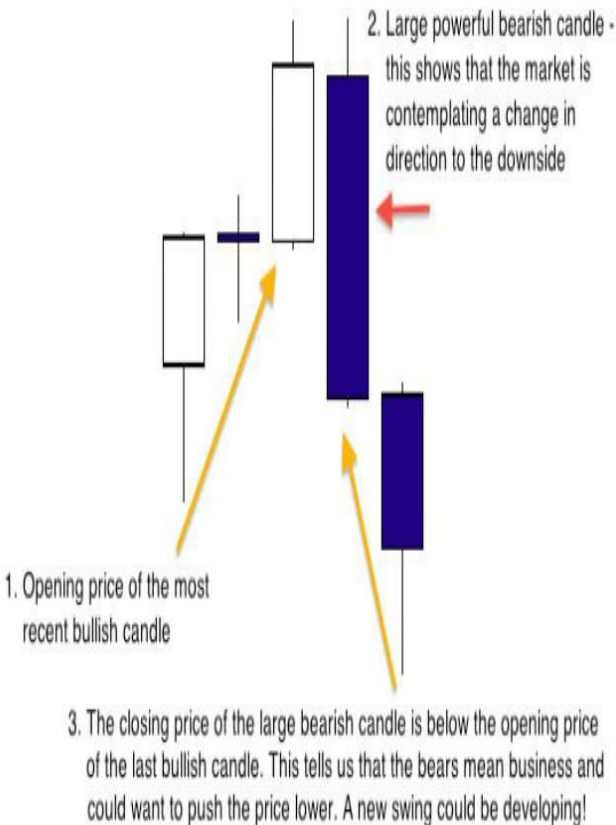
2. Bearish reversal candle

3. Bearish swing off the reversal candle



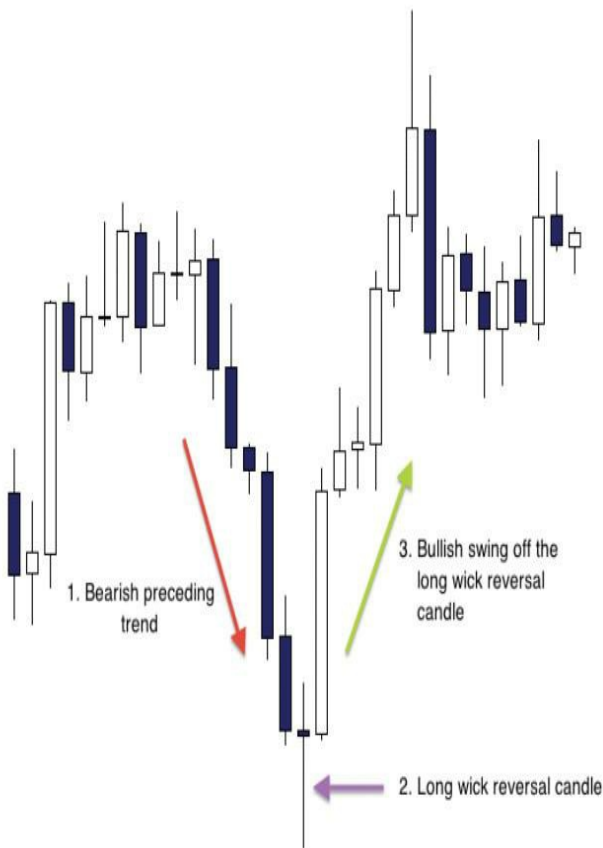
Notice how the large bearish reversal candle forming at the end of the bullish preceding trend has sparked a sell-off to the downside.

Again, let's look at the reversal candle itself a bit more closely:

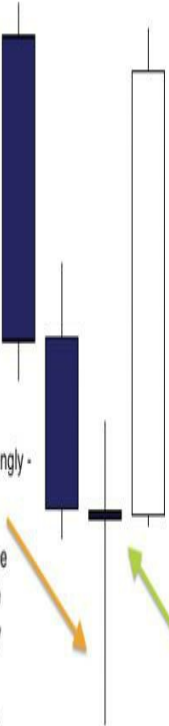


The second signal we look for that warns us that the market is contemplating a reversal is a candle that has a long wick (sometimes called a “shadow”) when compared to the size of its body. Long wicks show that the preceding trend could be beginning to run out of steam and that the market is thinking about trying to reverse direction. Again, this might sound complicated but it’s not. With a little practice you will be able to identify these signals very quickly and easily. It becomes second nature after a while - like riding a bike.

Here are a couple of examples to get the ball rolling - first a bullish long wick candle reversal:



And a little bit closer:

- 
1. The bears have been selling strongly - until this candle appears!
- The chart displays four candlesticks. The first is a tall, dark blue bearish candle with a long upper wick. The second is a shorter, dark blue bearish candle. The third is a very short, dark blue candle with a long lower wick. The fourth is a tall, white bullish candle with a long lower wick. An orange arrow points from the text 'They have managed to push price down quite far...' to the third candle. A green arrow points from the text 'The candle close price is very close to the open price...' to the fourth candle.

They have managed to push price down quite far, but the bulls have stepped in and pushed back very strongly.

When we see a long wick like this, it tells us that the momentum might be about to switch back to the bulls

2. The candle close price is very close to the open price, which means the bulls have taken back nearly all of the ground that they lost.

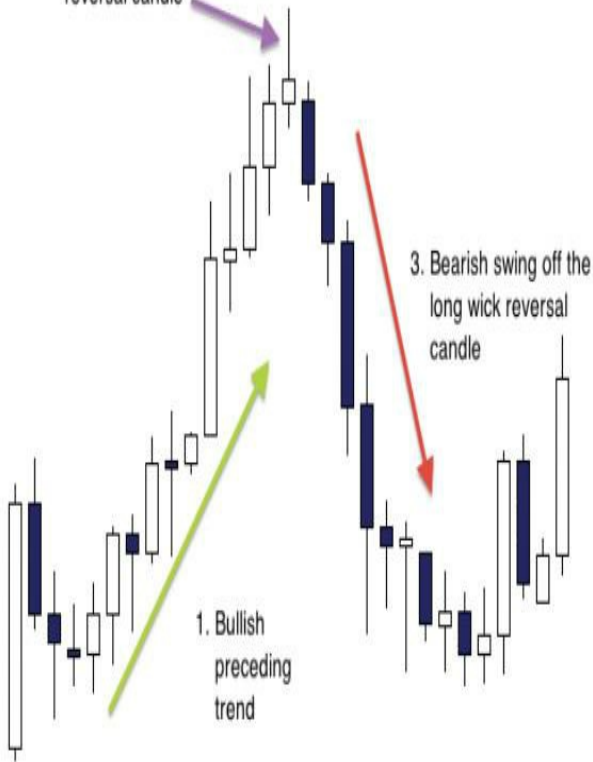
A new bullish swing could be developing!

Candlesticks that have long shadows can be extremely powerful at alerting us to areas where price might be thinking about changing direction. But like any form of technical analysis, they do not work all the time. You should never just identify a long wick candle and then blindly enter a trade in the opposite direction. Long wicks are just one of the tools we use to analyse potential market turning points. When we see a candle with a long wick on a weekly or monthly chart for instance, we should be thinking to ourselves that the move in the opposite direction, if it materialises, could be quite large. One weekly candle is often a few hundred pips in range. We should be thinking about ways we can

take advantage of this.

Here is an example of a bearish long wick reversal:

2. Long wick
reversal candle



1. Bullish
preceding
trend

3. Bearish swing off the
long wick reversal
candle

Readers who have come across candlestick analysis before will probably recognise some of these candle patterns and know their names. I suppose the long wick would be something akin to a doji pattern, and the first reversal pattern we looked at was probably along the lines of an engulfing pattern.

Although there is nothing wrong with conventional candlestick analysis, I sometimes think that the rules are very rigid about what constitutes “valid” or “invalid” patterns. Instead of worrying too much about learning the exact constituent criteria of a candlestick pattern (and its funny-sounding name), we should concentrate on reading price

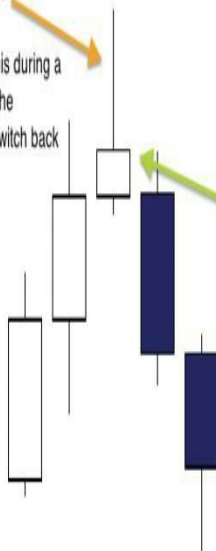
action as a whole, as if we are reading a book. A sentence doesn't lose its meaning because of a spelling mistake, just like a reversal doesn't stop being a reversal just because it is not identical to an example in a textbook.

Here is the chart example from above again, zoomed in a bit this time:

1. The bulls have been in control and buying strongly, until this candle appears!

They managed to drive price quite high with this candle, but then the bears stepped up and pushed back price strongly.

When we see a long wick like this during a preceding trend, it tells us that the momentum might be about to switch back to the bulls



2. The candle close price is not very far above the open price, suggesting that although the bulls win the battle for now, it is only a very marginal victory.

The bears are beginning to get confidence - a new bearish swing could be developing!

At this stage it is important to reiterate, as we said in Chapter Three, we are not trying to predict the future with these candle signals. We are just anticipating what the **market might be about to do**. If we get it wrong a few times in a row it is not necessarily a poor reflection on our skills as a trader or a reader of price action. It is just that the market did not act as we thought it might on these particular occasions.

Sooner or later the market will perform in line with our expectations and develop into a nice long swing. Remember, the market can only go up, down or sideways, so we already have a 33% chance of being right, even if we

do no analysis at all!

When the market does move in accordance with our expectations our job is simply to make sure that we make the most out of the opportunity. When the market moves against our expectations we get into defensive mode and quickly close trades if they are showing losses. That's the name of this game - there is nothing more to it than that.

You should take some time now to scroll back through your charts and practice identifying good preceding trends together with candlestick reversal signals. You will find that these signals do not always work; in fact they might only work out perhaps 50% of the time,

maybe even less. Hopefully by now you will have realised why traders of the PAST Strategy would be extremely happy with a 50% trade success rate. If you haven't, you will be reminded again in the coming chapters!

Chapter Six

In the last chapter we looked at ways of identifying where a swing might be beginning to occur on a large (“anchor”) timeframe, such as a weekly or monthly chart. When these signals are successful, they often result in a move of hundreds or possibly even thousands of pips. However if we wanted to enter the market using these anchor charts alone, we would have to risk a lot of pips to make sure that our stop was in an appropriate place. Mostly for these types of reversal candlestick signals it is recommended that a stop is placed above the high of the signal candle, which for a weekly or monthly signal

could be hundreds of pips from our entry price.

But, as we have said already, we want to keep risk very tightly controlled. A 300 pip stop is simply too much. So instead of entering the market and setting a stop on the anchor timeframe, we drop down to a lower timeframe to see if we can make the same entry, but with tighter risk.

When moving to a lower timeframe we should try to adopt a flexible approach in relation to which one we use. Sometimes traders treat different timeframes almost as if they are totally different instruments. The price traces the same path no matter what timeframe

you are looking at, or whether you use candles, OHLC bars or just lines. They are all simply different ways of displaying the same information.

I personally like to just flick around lots of different timeframes to get a good overall perspective on what price is doing. However I also like to do my analysis on the basis that the higher the timeframe, the more important the signal. If the weekly timeframe is showing a strong reversal signal that suggests that price is likely to move to the downside over the coming sessions, I won't be second-guessing my opinion just because the 5 minute chart happens to look decidedly bullish.

If novice traders find at the beginning that constantly jumping between timeframes is a bit confusing, they could simply stick to using the weekly timeframe as the anchor chart, and then just taking entry signals from either the 4 hour or the 1 hour charts. These three timeframes together will give you a very good overall idea of current price action.

So, we have now looked at the first part of the trading strategy, which is locating a candlestick reversal signal on a large anchor timeframe chart. We will now look at the second part of the strategy, which is to drop down to a lower timeframe to make a nice tight entry for small and controlled risk.

For these entries we use another simple but very effective price action pattern - the trendline break.

Chapter Seven

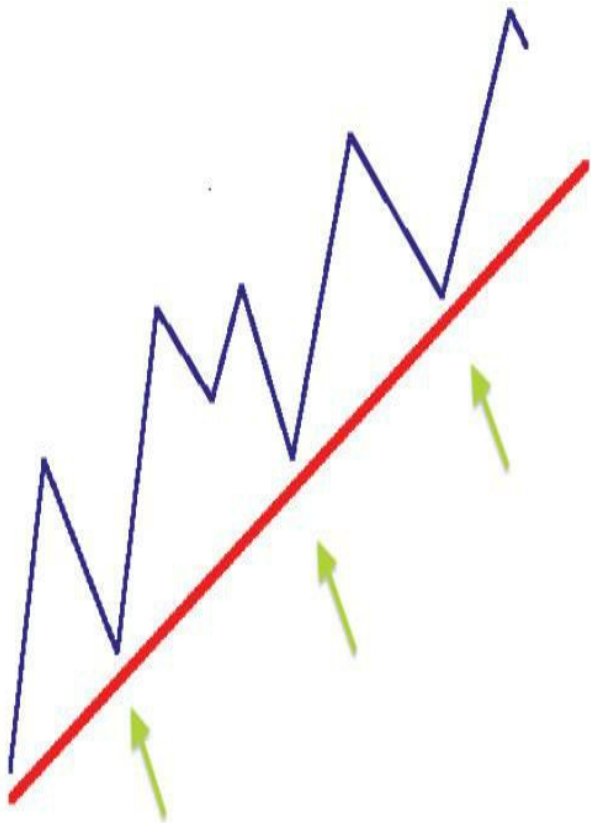
“I absolutely believe that price movement patterns are being repeated; they are recurring patterns that repeat over and over. This is because the stocks were being driven by humans – and human nature never changes.”

- Jesse Livermore

You will notice that when a market is trending, in any timeframe, it tends to move in a zig-zag fashion, like this:



When we see a market behaving like the above, we just see if we can connect the lows with a straight line, and if we can, we have ourselves a trendline. Et voilà:

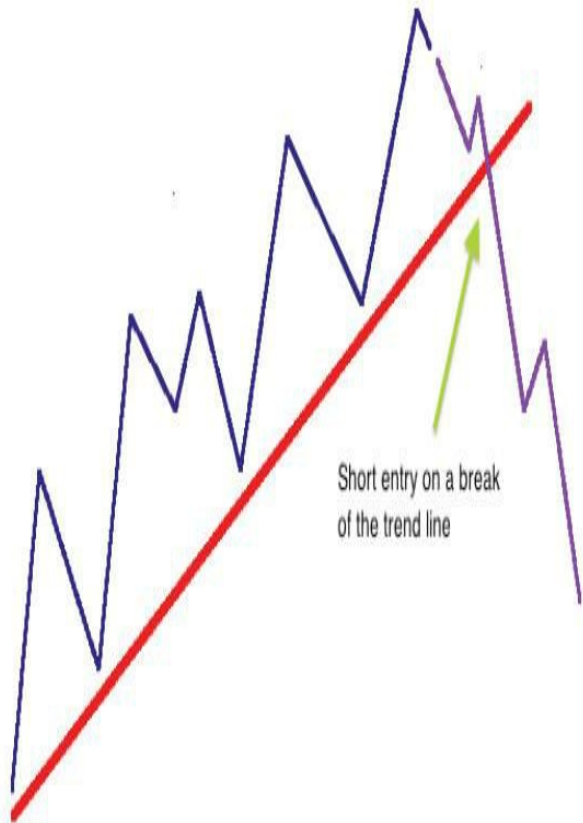


We can draw trendlines between any two or more points on a chart. Generally the more touches by price off the trendline, the stronger it is. Quite often the stronger the trendline is, the bigger the move is when it does eventually break. So more touches are better, but don't totally ignore trendlines with only two or three touches, they can produce good trades too.

In addition, we shouldn't get too distracted by whether the trendline matches up exactly at each low or not. Some people when they are drawing trendlines get slightly obsessed by whether you should only draw from the precise low of the candle, or the close

price, or whatever. As is the case with so much in trading, there is no right or wrong answer; it is simply a matter of style. Practice and develop your own way of drawing them - it's your trendline after all, draw it however you think is best!

Once we have our trendline, we want to enter a trade to the short side if and when it breaks:



Now, this will not happen every time, but quite often we will notice that when a trendline breaks, price will move quite quickly away from it. This is a great feature of trendline breaks and is the main reason why they form part of the PAST Strategy. When price moves quickly into profit, it gives us the opportunity to control risk very tightly; if price moves away from the entry point quickly, this means the size of the stop loss required is much smaller.

You often hear traders talking about giving positions “space to develop” or “room to breathe”. The PAST Strategy rejects this; stops should never need to be any bigger than what is absolutely

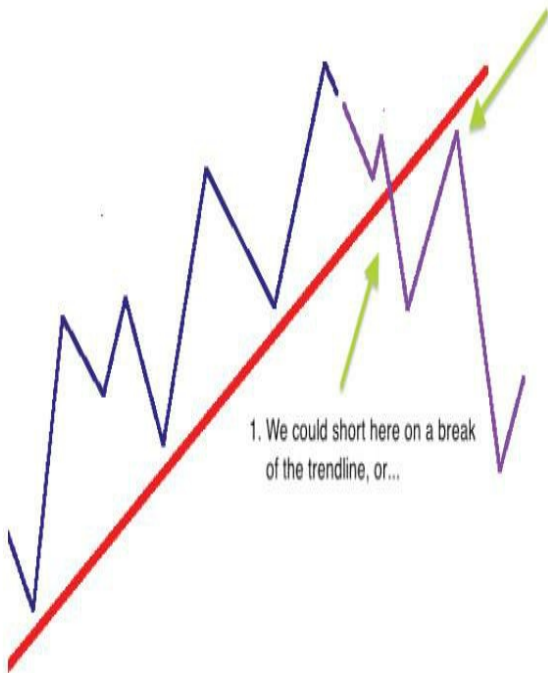
necessary. It is perfectly possible, with some practice, to enter the market in a precise and accurate fashion and expect price to move quite quickly into profit. If price moves quickly into profit we know we were correct. If price goes nowhere or moves against us, we should listen to what the market is telling us, acknowledge that on this occasion we were wrong. We close the trade. There is no need to allow a trade go 100 pips into the red before we start wondering whether it is going to work out or not!

In the last example in the graph above, price broke the trendline and moved away from it quickly. It's great when price does this because it makes for a clean and simple trade. However,

unfortunately sometimes the market likes to make us work a little harder for our money. After you have become familiar with trendline breaks you will notice that sometimes after it breaks, price comes back up to test the trendline again from underneath, before then moving away.

This is perfectly normal and we should expect it and be prepared for it to happen regularly when we are trading trendline breaks. Once we know that this occurs we can be ready for it to happen and adjust our trading accordingly.

2. ...if we missed the first break,
we could wait to see if price
re-tests the trend line from
underneath and short from there!



1. We could short here on a break
of the trendline, or...

Some people get frustrated at retraces. The PAST Strategy loves retraces to beneath a trendline though - they allow you to get in at a very nice price and often make the best trades.

Chapter Eight

“1. Cutting losses

2. Cutting losses

3. Cutting losses

**If you can follow these three rules,
you may have a chance.”**

- Ed Seykota

As we have said already, our primary objective, first and foremost, is to control risk. That means setting the appropriate stop loss orders for our trades.

It is not possible, or indeed preferable,

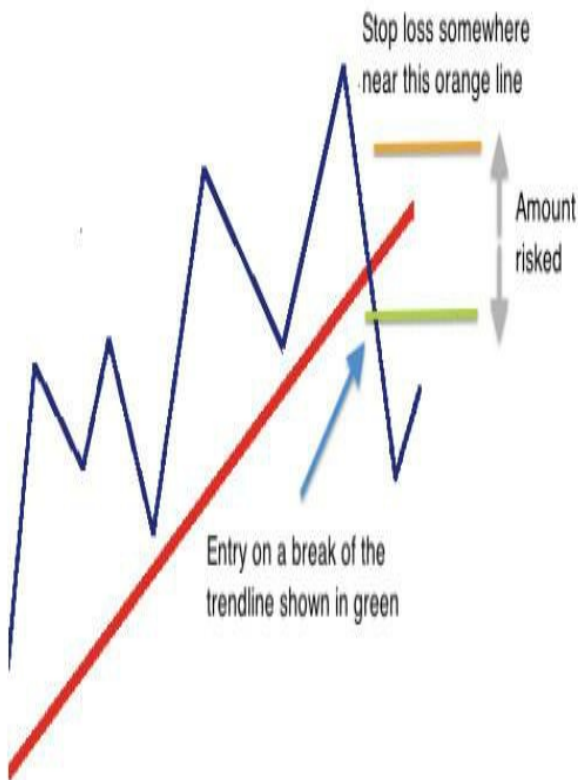
to strictly define where a stop loss should go, or how many pips it should be from your entry. Every single trendline will be different and so we need to learn how to deal with each one as it presents itself to us. Instead of fretting over whether our stop is in the “correct” place or not, just keep in mind the overall objective. We want to put the stop in a place that will control risk as tightly as is possible, but it needs to be realistic too. Setting a stop 3 or 4 pips from entry will almost definitely get hit, whereas a sensibly placed stop 15 or 20 pips away from entry might be quite unlikely to be hit, depending on the chart. Having said that, if we are trading on a 1 hour chart and we have a 100 pip

stop we are certainly not tightly controlling risk - we can do much, much better than that. It is about striking a good balance.

Although there are no hard and fast rules, there are a few guidelines we can bear in mind when we are deciding where to put a stop. In simple terms, we want to set the stop at a level that if it gets triggered, the market is loudly and clearly telling us that it is not ready to behave quite as we would like. The market tells us we are wrong when it manages to overcome levels that it really shouldn't be able to if it was minded to be moving in the opposite direction.

On a simple and straightforward

trendline break, we should try to see if we can place the stop loss above the trendline itself:



Another option that might be available to us, depending on the individual trendline break concerned, is to locate a stop above both the trendline and a recent high. Remember, we want to locate the stop in a place that if price manages to trigger it, price is telling us that we are wrong. If price has the ability and strength to recover to the extent that it can make it back above both the broken trendline and a recent high, there is no doubt that the market is telling us that it is not ready to move to the downside just yet.

If the market isn't behaving as we expect what should we do? Leave the trade open and sweat it out? Wait and watch

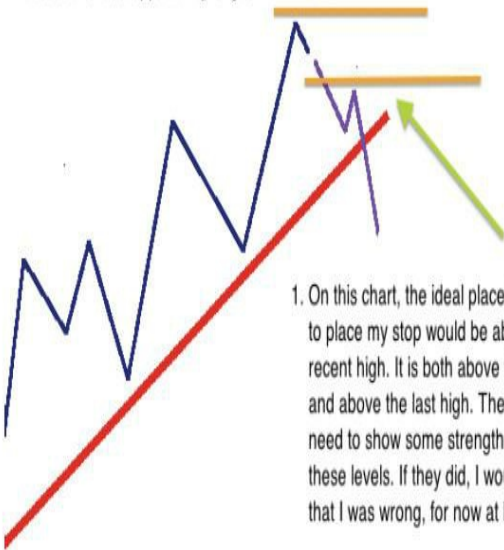
the price move higher and higher, taking with it chunks of our account equity? No, of course not. We close out the trade, take the loss while it is small and manageable and then wait until the market is behaving in accordance with expectations again.

There are days when the market does exactly what we want - a sweet, clean, fast trendline break when price moves into profit straightaway would be one of those days. We should be active in the market on these days. There will also be days that the market behaves like a spoilt, angry child - it will break, retrace, jump around and generally frustrate you. On those days, it is far better to simply take a step back and let

the market get whatever it is out of its system.

Here is an example of setting a stop above both the trendline and a recent high:

2. The other option would be to place a stop above this high - it is down to personal preference. In my opinion however, a stop here would be a little bit further away from the price action than is necessary. Remember, we want to keep risk to a minimum at all times, while giving winning trades the best opportunity to grow.

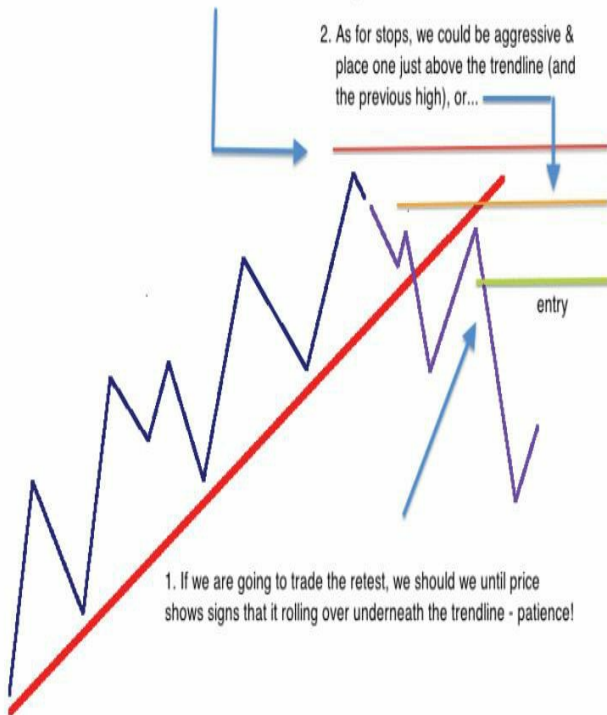


1. On this chart, the ideal place for me to place my stop would be above this recent high. It is both above the trend line and above the last high. The bulls would need to show some strength to overcome these levels. If they did, I would know that I was wrong, for now at least!

This chart shows an example of where I might consider putting my stop if I was entering on a retest of the underneath of the trendline:

3. ...we could be a bit more conservative and place it a little further away - above this high would be fine - the choice is yours!

2. As for stops, we could be aggressive & place one just above the trendline (and the previous high), or...



1. If we are going to trade the retest, we should wait until price shows signs that it's rolling over underneath the trendline - patience!

To summarise then, there are two ways we can trade trendlines: either on the initial break or on a retest if it occurs. These two methods however will inevitably sometimes overlap.

For example, say we entered on an initial break and put our stop above the trendline and a previous high. Price moves into profit initially but then starts to retrace back up the trendline. But because the trendline is sloping upward, the stop we placed above it when we opened the trade could be below it now. So it gets triggered for a loss. But we then notice that price is struggling at the underside of the trendline, so we could decide to enter again, at the retest.

This might sound a little bit complicated now, but once you start to practice these entries you will become better at noticing how price moves. If you are unsure, the main point to remember is that you must keep your risk under control at all times. If you are doing that well, where exactly you enter the market in relation to the trendline is not so important.

We must remind ourselves, when we are looking at these examples, of the difference between theory and practice. In theory, price should bounce nicely off trendlines, and then when it breaks it should do so cleanly and profitably.

In the real world, the market might

decide to completely ignore our nicely drawn trendline and there is nothing we can do about that. There is no magic in trendlines in the exact same way as there is no magic in any technical analysis. The trendline is simply a tool to suggest what might be a good entry point and a good place to set a stop loss to manage risk. It is nothing more than that.

Price sometimes overshoots, reverses, hesitates, often it just goes nowhere. It also has this profoundly annoying tendency to just trigger our stop and then move off smartly in the direction we originally expected to go. We have to accept that this is simply what the market does. We can't change it; if we are to have any chance of succeeding in trading

we have to recognise that it happens and work around it. When the market isn't playing along to expectations, we go into defensive mode, we conserve capital and we don't let losses build up. We certainly don't try to force trades. On the occasions that the market it is behaving itself, we go on the offensive, and make as much money as we can while the opportunity remains open.

Chapter Nine

“I try to assemble facts and decide what kind of scenario I think will unfold.”

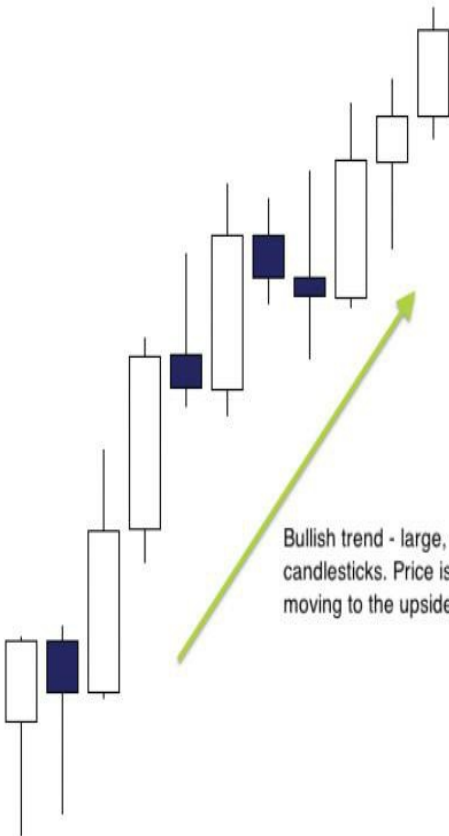
- Bill Lipschutz

So far we have looked at longer term candlestick reversal signals and then shorter term trendline breaks. Let's now look at a worked example of how we put the two together to look for potential trade entries.

Step 1: Identify a good preceding trend on a longer timeframe chart

Here is a good one on a weekly

timeframe:



Bullish trend - large, strong, bullish candlesticks. Price is obviously moving to the upside.

Price in the above chart is very obviously in a strong uptrend. All trends come to an end at some point though. If price was to show signs of changing direction, we could consider starting to look for opportunities to short it, in the anticipation that a correction could be about to occur. Perhaps even the very start of a new bear trend could be forming. The truth is that we don't know, either way. If the signal turns out to be correct and a sell off occurs, we will aim to put ourselves in a position to profit as much as possible. If the signal fails and price just continues to the upside, we want to control our risk and lose the least amount possible.

Step 2: Wait for a reversal signal to occur

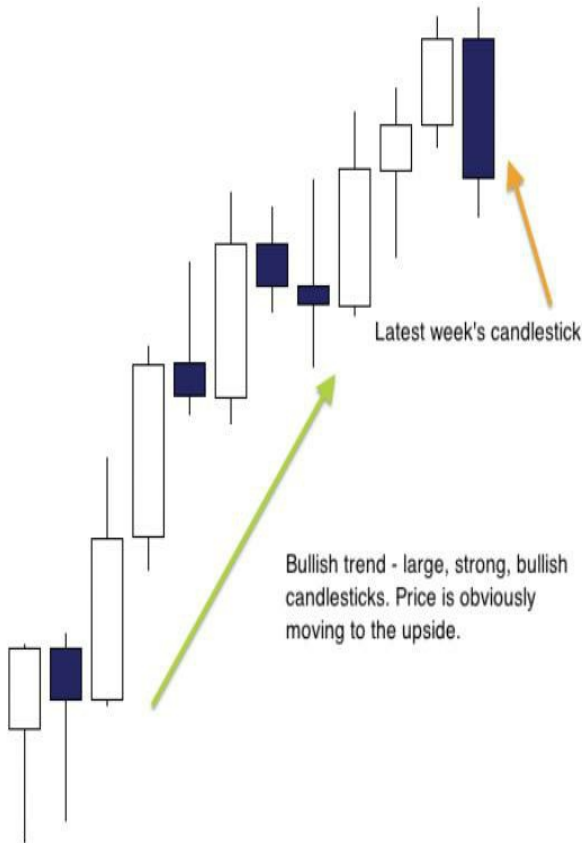
The market as shown in the chart above shows no sign whatsoever of turning around just yet and therefore if we start trying to short it now, we are just fighting a strong trend and will most likely lose money. This is very important - many traders fail to heed this rule and try to trade reversals before the market actually shows any real sign of turning around. We need to wait for the market to give us a firm signal that it could be turning before we do anything.

Do not trade before the market gives you a signal - there will be plenty of time to get involved after it has turned.

Wait for the market to show what it is intending to do first, then get involved, not the other way round!

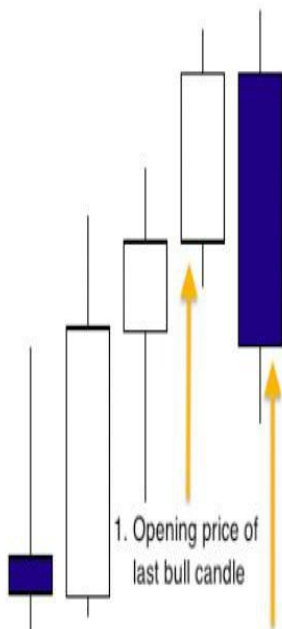
So, confronted with the chart above we would keep an eye on it but not do anything until we saw one of the reversal signals we looked at in Chapter Five. We want the market to give us an indication that it is contemplating a change in direction.

After the next week's price action the chart now looks like this:



Hopefully if you have been practicing being able to identify the reversal signals that we discussed in Chapter Five you will recognise that the latest candle is signaling that the bears have woken up and have started to strut their stuff. The sellers think that the bull trend has been going for long enough and it is time that they fought back. The candle is a large strong bearish one and has closed below the opening price of the previous bull candle. We are now starting to get interested, as the market has given us a good firm signal.

As we usually do, let's take a closer look:



1. Opening price of last bull candle

3. The closing price of the bear candle is below the opening price of the last bull candle

2. The sellers have really shown what they are made of with this candle. The buyers have been pushed right back down and the candle has closed below the opening price of the last bull candle. It looks like the bears could be about to take control and we could be in for a further move to the downside!

Once a signal like the above occurs, we can then begin to position ourselves to take advantage if the price declines further in the coming weeks as we expect it might. Even if this weekly signal only results in two or three more bearish candles before a resumption of the previous bull trend, there could be at least a few hundred pips available to us if we know what we are doing.

Before we move on it is important to note that once we see a bearish signal like on the above chart, we are now in sell mode and are only looking to play the market to the downside. We are not interested in buying opportunities right now.

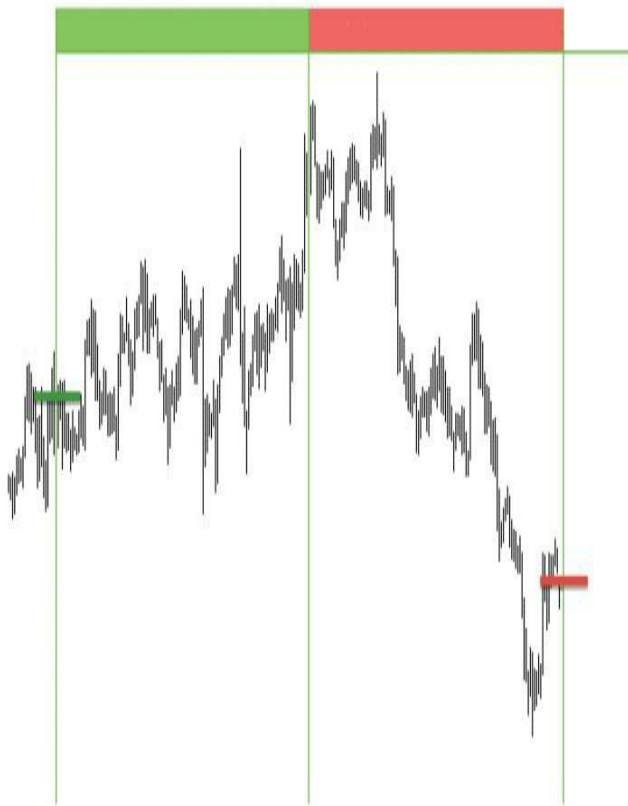
Once we see a reversal signal like the one above, we then drop down to a lower timeframe chart to look for trendlines to form, and getting short when they break.

So let's see, if we had been trading the above example in real time, what we would have been confronted with.

Step 3: Drop down to a lower timeframe

Here is what the weekly reversal signal looks like on the hourly chart. The two shaded areas, green and red, are the two candles that comprise together the reversal signal. We can see that price was moving up cautiously during the

first candle but during the second candle it fell away quite sharply. The open price of the first candle is marked in green on the left hand side of the chart and the close price of the second candle is marked in red on the right hand side of the chart. We can see that the second candle closed below the open price of the first, which is a factor we look for when searching for reversal signals.



As we mentioned before, there is no right or wrong timeframe to drop down to, just whatever we feel gives a good perspective on what price is doing. Personally I like to make sure that my chart is zoomed out at first so I can get a good look at previous price action - at the very least we should be able to see all of the price action that formed the reversal signal itself on the chart.

Sometimes traders tend to zoom right in and concentrate almost on individual candles. That's fine for making precise entries, but in terms of getting a good overall feel for what price is doing, we should try to fit as much price action on our screen as possible, at the beginning

at least. For this example we are going to stick to the 1 hour chart.

Step 4: Trendlines

So let's fast forward price on a bit now so we can see how it behaved during the week following the signal, which is colour-coded in blue. Remember, we are looking for lows that we can join together to form trendlines. Once they break we then can then think about trading short.

The first two lows that jump out are highlighted with yellow arrows in the chart below - let's see how they played out:



So the first trade of the week was a loser. Not to worry, as long as we are controlling our losses and keeping them as small as possible we are doing our job.

We can use the new low now to draw another trendline:



This time we get a nicer break, and price moves away a bit more quickly. That is what we should be looking for - when a trendline breaks properly, we should know about it. However although price breaks nicely on this occasion, and our trade should be in profit, there is little in the way of follow-through afterwards and price starts to consolidate sideways. This is perfectly natural and we should be ready for this to occur regularly, especially during quieter trading sessions, such as when the Asian markets are open.

After price has finished consolidating, look what happens next:



Price tests underneath the trendline, to the pip

During the period of consolidation (between the red and green arrows) the price has been eyeing up the underside of the trendline. When you become more familiar with the price action of markets generally, you will notice how price loves to move back to retest a level that it has broken. I like to think of it in the same way some people will go through a door, lock it, then they try the handle to make sure it is locked, and then leave. Price often does the same thing with broken trendlines, not all of the time, but some of the time. Sometimes it is in too much of a hurry to check! Be ready for it, and be prepared to take advantage of it when it happens.

After testing the underside of the

previous trendline, price falls away. It then breaks another trendline we could have drawn by joining the lows of the consolidation from the night before:



Hopefully readers are beginning to see a pattern emerge here. These trendline breaks occur over and over again in the markets. When we notice patterns such as these we should be always thinking of ways we can take advantage of them.

After we identified the reversal pattern on the weekly timeframe, we thought that it was possible that the market might take to turn to the downside. A reversal on a weekly chart can easily be a few hundred pips, if not more. However, instead of risking perhaps 300 pips to set a stop loss on the weekly chart, we can zoom in and make precision entries on the lower timeframe charts with our trendline breaks.

As we continue on through the week:



Some more potential trendlines and entry points that occurred through the course of the week

Price consolidates and then moves, consolidates then moves. In a downtrend, like what we are observing above, the downside breaks can be quite quick and aggressive. These are very good trading conditions. Also, on some occasions, we notice that price retraces to test the broken trendline from underneath and then continues in a downward direction.

Now, the above week's price action was selected because it is a good example, not every week will have such nice clean price action like this. Often we might have to endure a few losing trades before we get one that moves into profit nicely for us. Or we will miss some

trades, simply because we are working at something else or away from the trading screen. This is largely besides the point. The key thing to remember here is that once we have identified a reversal signal on a large timeframe which is successful, the price action will often give us ample opportunity to get in on the move with very little risk, perhaps as little as 10 - 20 pips.

Chapter Ten

“Be patient with winning trades; be enormously impatient with losing trades.”

- Dennis Gartman

It is clear that the price action we looked at in the last chapter offered at least 2 or 3 opportunities to enter the market and make some pips. These trendline breaks can certainly be profitable in their own right. It could be a perfectly plausible strategy to simply trade these trendline breaks alone, targeting perhaps 20 – 30 pips on each break.

However a core objective of the PAST

Strategy is not only to control risk but to also try to stretch out reward as much as possible. We measure risk on a small timeframe but target reward on a larger timeframe. In this context therefore, as we did our original analysis on the weekly chart, we could have reasonably expected price to continue further to the downside after the first week, and potentially for further weeks thereafter. This is not luck or fluke, it is a legitimate expectation based on sound weekly candlestick analysis.

Very often you see traders using longer timeframes to gauge market direction and then moving down to a lower timeframe to make an entry. The PAST Strategy is not unique in this respect.

However, most of the time when you see traders take direction from a daily or weekly chart, they then close their trades at 30 or 40 pips profit! If the market is moving in a particular direction on a large timeframe, that means that it is covering a large number of pips to do so - we should be trying to take full advantage of the movement and making as many pips as possible.

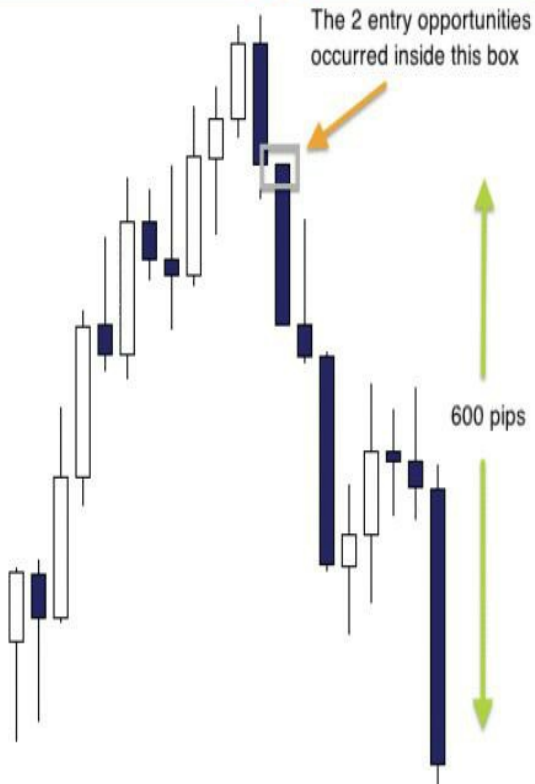
The chart below shows the first profitable trading set-up encountered during the trading week that we have been using as an example. Price broke a trendline, retested it from the underside, and then fell away. It's a very nice trade. We could have either entered on the initial break, or indeed on the retest.

Some people trading this setup might have had a tight stop set after the initial break and got stopped out for a very small loss, and then re-entered on the retest, with a stop above the trendline. There is no way we should be trading this setup with any more than, say for argument's sake, 20 pips per trade, or 40 pips in total. So our risk, set on the hourly timeframe, is 40 pips.



So our risk is measured on the hourly

timeframe - but we can see below what can happen if reward is measured on the weekly timeframe. Remember the weekly chart on page 34 showing the reversal signal? Here it is again on the next page:



The trade that was taken on the hourly timeframe developed on the weekly timeframe into a move of nearly 600 pips, or a potential risk v reward ratio of almost 1:15.

Do 600 pip opportunities occur after every weekly reversal signal? No, of course they don't. Sometimes price might only move a couple of hundred pips. Often price won't really move for us at all and we might take a loss. On still other occasions price could move a thousand pips in our direction. The key point is that when we enter a trade, we should always be thinking about how far could it possibly go, and how can we take advantage.

Although it makes little sense, the default setting in our brains encourages us to keep losing trades open, allowing the losses to accumulate. And then as soon as a winning trade begins to develop and grow, we rush to close it as quickly as possible.

We need to train ourselves to do exactly the opposite.

Chapter Eleven

“The way to build superior long-term returns is through preservation of capital and home runs...When you have tremendous conviction on a trade you have to go for the jugular. It takes courage to be a pig.”

- Stanley Druckenmiller

We have spent a considerable length of time in the last few chapters looking at ways to enter the market in anticipation of a large move. We like the idea of entering the market on trendline breaks or retests, allocating risk (stop losses) on a lower timeframe, but always remaining mindful of the large move that

could be coming. If we are anticipating that price is going to move to the downside, we look for breaks of bullish trendlines to sell; if none occur, then we simply don't trade.

Not every trade we take will turn out to be one that can return hundreds of pips, but we believe that as long as we control risk, opportunities to make large gains will inevitably arrive, sooner or later. The gains from the large winners should be more than enough to not only compensate us for the small losses, but to return a good profit also.

It's time now to begin to look more closely at techniques we can adopt to let these winning trades stretch their legs.

Once we have a successful trendline break or retest, and price has made its way some distance away into profit, the first thing we should consider doing is taking risk off the table completely for the trade, and setting a stop loss order at the entry price, i.e. at breakeven. This is sensible trading practice; at least if price retraces and triggers the stop we will have lost nothing. Remember, the first rule of good trading is capital preservation.

Of course, how far we allow the trade to get into profit before we bring a stop to breakeven is a matter for each individual trader to decide. You will find that after some practice you will get a good feel for it. If we were to specify a good rule

of thumb, perhaps allow the trade to get the same distance in profit from your entry as your stop was. So if your stop was 20 pips, once your trade is 20 pips into profit, think about bringing your stop to breakeven. Again, this is just a suggestion, after some practice you will be able to get a good feel for when the time is right to tighten risk.

Secondly, we need to define in advance the criteria that will need to be met before we will close the trade. Sometimes traders use criteria that are based on what they are feeling or doing rather than what the **market** is doing. The PAST Strategy encourages us always to listen to the market first - we do not get into the market unless the

market gives us a signal (longer term candlestick reversal signal) and we should not get out unless the market gives us a signal.

What should the signal be? Traders are largely free to decide what the criteria is themselves, but the recommendation must be that the primary objective is to give the trade every chance to develop into as big a winner as possible.

My own personal preference is to keep my trade open until I see a reversal candle on the anchor timeframe - i.e. if I am trading a swing to the downside, I will wait until a bullish candle forms that closes above the open of the most recent down candle. As with everything

in technical analysis, there is no magic involved in this signal - it is just an objective occurrence that once it happens I cannot argue with it.

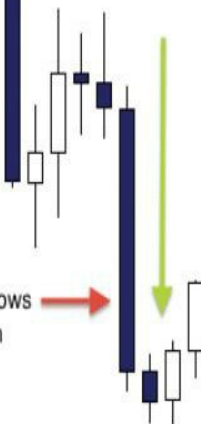
Taking the weekly example we were looking at in the last chapter, a reversal looks like this:



2. The last bearish candle is quite short, indicating that the bears might be running out of steam. The next candle is a bullish one, and as it closes above the open price of the last bear candle, we say that it is stronger. The bulls are now in control, and we should think about closing bearish trades.



1. This long candle shows that the bears are in total control



There are other methods that traders could use to determine whether a swing is coming to an end - some might consider using a moving average for instance - when a moving average flattens out it could be an indicator that the trend is losing momentum. Another way to potentially determine when to take profit might be to join consecutive lower highs to form down trendlines. Similar to the way we use breaks of upward trendlines to get into the market, we could use breaks of declining trendlines as an indicator for when to get out.

There is no such thing as a perfect indicator to tell you when to get out, but

that is not what we are looking for. We simply choose an indicator to use as a tool to achieve an objective. In this particular instance, the objective is running winners for as long as possible. If anything, if you are finding it difficult to make your mind up whether you are closing a trade too early, the default position should always be to err on the side of leaving the trade open. If you are unsure, leave it open. You'll find in time that if you look after the losers, the winners will tend to look after themselves.

Chapter Twelve

“I have two basic rules about winning in trading as well as in life: If you don’t bet you can’t win. If you lose all your chips, you can’t bet.”

- Larry Hite

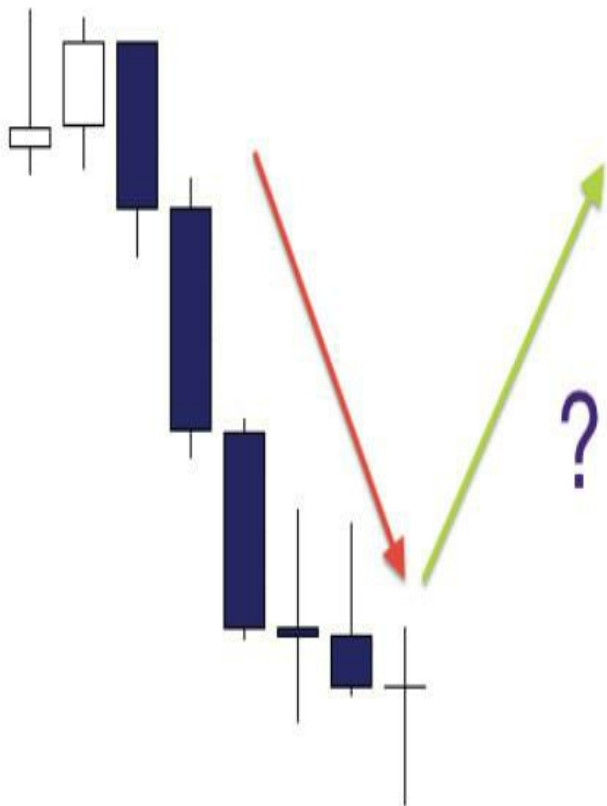
We have already acknowledged that when we are analysing our anchor timeframe charts we really have a very limited ability to determine what direction the market is going to take. Instead of trying to do something we are unlikely to succeed at, we prefer to concentrate on doing something that is within our control - namely trading more aggressively when the market behaves as

we hope it will, and trading defensively when it doesn't. This style of trading demands that we are prepared to accept that we will encounter quite a number of losing trades, however, as we are trading with a good reward to risk ratio, we can comfortably sustain some losing streaks before our ability to return a profit is called into question.

Instead of trying to avoid losing trades or pretending that they don't exist, we adopt a more pragmatic attitude; we recognise that losing trades are simply a fact of trading life that we must accept and get on with. Losing trades are inevitable, but winning trades are inevitable too - all we have to do is be patient and wait for them to come along.

With this in mind, let's take a look at another weekly reversal signal. However, this time it is a signal that doesn't play out according to expectations. As I am sure you have gathered by now, the PAST Strategy can be traded either long or short. So this time we will look at an example of a bullish reversal - so we will be looking for buying opportunities on trendline breaks to the upside.

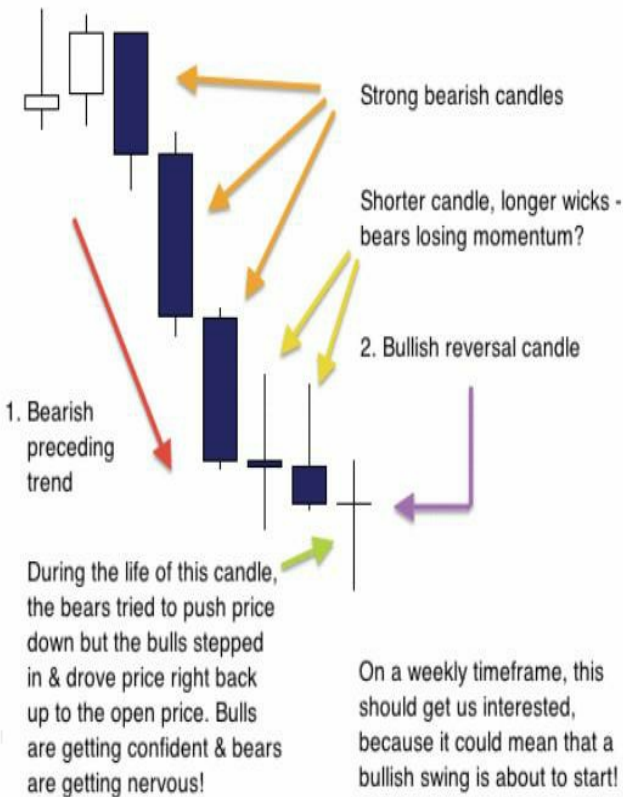
Take a look at the following chart:



Knowing what you do about how the PAST Strategy, what are your thoughts regarding the above weekly chart?

From my own personal perspective, if I encountered this chart on my screen I would be looking forward to the coming trading week. The strong preceding trend is there, price is obviously moving down, and it finishes off with a very nice reversal candle at the bottom. The bears could be running out of steam and the bulls are thinking about taking a shot at pushing the market back up. I would be getting ready to zoom in on Monday morning to see if there are any good trendlines that I could watch for breaks to the upside.

Before we move to the lower timeframe charts, let's take a closer look at the potential reversal itself:



As we become more used to looking at price action, we will become better at recognising when the market is moving with momentum and when it is becoming less certain about direction. The first three bearish candles, with the orange arrows pointing towards them, are good examples of a market moving with momentum. The candles are nice and long, and the wicks are short. As soon as the candle opens the bears are in control from the beginning right through to the end, when the candle closes.

The next two candles, with the yellow arrows pointing towards them, are examples of a market beginning to lose momentum. There are wicks in both

directions and the candles are shorter. The bears are still winning, because the candles are moving down, but they are not winning the battles convincingly anymore. Does it mean that the bear swing can't continue? Absolutely not. But it does give us advance warning that the bulls are considering mounting a challenge. We should be aware of this and try to position ourselves to profit if they do manage to take control of the market.

Let's zoom in now and look a bit closer. For this example we are going to use the 4 hour chart. The reversal candle is colour coded in red and the preceding candle in green. The opening and closing prices are also marked in red and green.

We can see that the opening and closing prices are almost equal.

We can fast forward on now through the next week's price action. Remember, we are now looking out for trendlines that we can help us define entry points for long trades.



The next week is colour coded in blue.
Do you see any points that you could
join together to form a trendline yet?



Remember, the trendlines are a matter of personal style; no two people will draw identical trendlines. You might draw a trendline on the above chart that I wouldn't, and vice versa.

If there is to be one guiding principle when it comes to trendlines, it would be to try to draw the one that looks like it would be the most obvious to everyone looking at the chart. Don't try too hard. When lots of people are placing their orders around the same trendline, that's what causes the movement in price when it breaks.

Here's my first trendline attempt:

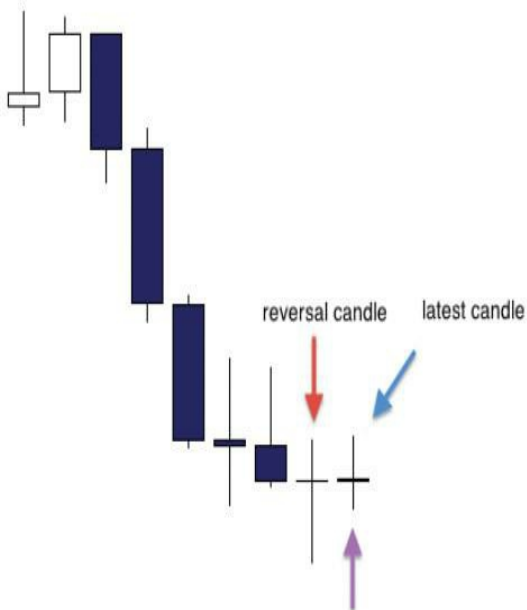


Notice above how when the trendline breaks price moves away from it smartly - this is what we want to see happen. Unfortunately however on this particular occasion, despite the initial jump price does not continue to follow through in a bullish direction; it eventually retraces back down to beneath the trendline. Despite this, we should have had ample opportunity while the trade was in profit to tighten risk and set a stop loss to breakeven or at least only a very small loss.

Traders could also have potentially considered taking a long position on the retrace to the trendline. In this particular example there was in fact a weak bounce

(look at the candle the blue arrow is pointing to) from it but the bulls couldn't get any traction and price then continued to fall. Again, if we did take a position from this trendline, we should be aiming to either have taken a small loss or perhaps to have a stop set to breakeven. Either way, the loss should never be allowed to become a large one.

How does the week's price action look like back on the anchor chart?



the next week's price action is quite tight,
price hasn't moved very much, and similar
to the reversal candle, the candle closes
at almost the same price as it opened.

Ok, so we expected price to move to the upside off the reversal candle, but this hasn't occurred. We have had two potential long trades during the week; one off a trendline break and then another on a retest. Neither have worked out, but we lost either very little or nothing at all. That's excellent, because it means we are controlling risk. When a signal doesn't work out exactly as we hope, we need to ask ourselves the following important question:

Does this latest anchor candlestick call our bullish (or bearish) outlook into question?

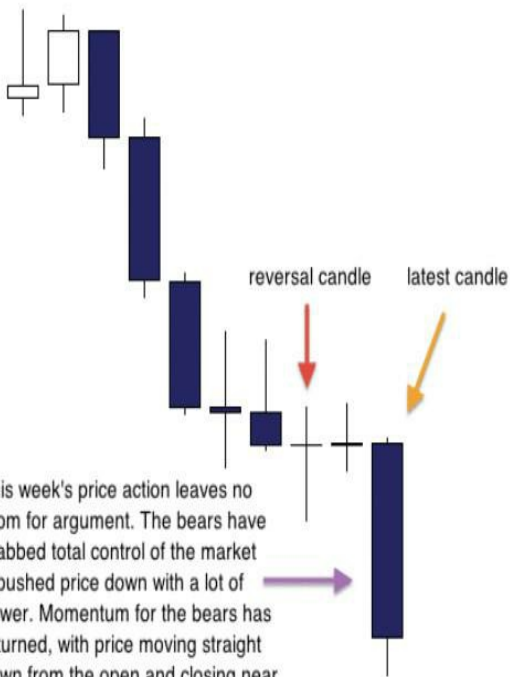
For me, in this instance, the answer to

that question is no. The price action could be seen as consolidative in nature, and granted, the bulls have yet to take control of the market. However there is no evidence from the week's price action that suggests that the bears have the power to push price down much further either. Each trader will form their own view on this, but if I were trading the above chart, I would still very much be open to the idea of taking more long opportunities on trendline breaks.

Let's fast forward once more and look at the next week's price action on the weekly chart, colour coded in orange this time.

What are your thoughts on the latest

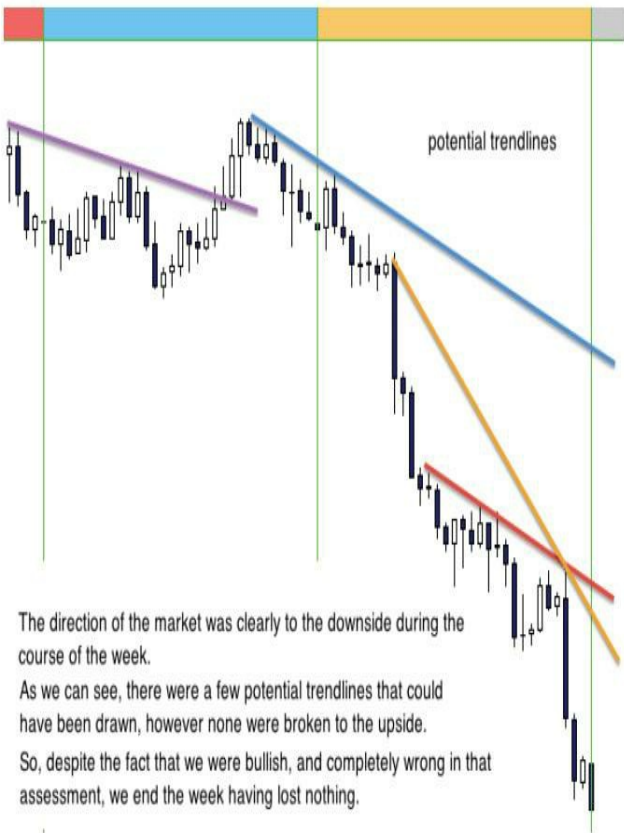
candle? Would you still be bullish now?



As referred to in the chart above, the market has just told us something, loud and clear. The bulls are out of the game now. The reversal candle was just a result of the bears stopping to take a breath and now they are back selling again. We need to listen to the market when it gives us signals like this. The case to buy now is over, and we should look elsewhere for other opportunities. What traders should never do is ignore the market when it is giving them a clear signal that their directional view is incorrect. The market is speaking to us constantly - the above chart is a good example of it screaming at the bulls to get out of the way. Unfortunately a lot of the time traders are prone to making the

mistake of trading what they think and not what they see.

But what about our trades? Surely being so utterly wrong on our prediction of the future direction of the market must have hit us hard in our pockets? Well we already know that we are carrying either no loss or a small loss on our attempt to enter long the previous week. Let's look at the latest week on the four hour chart (colour coded orange):



The direction of the market was clearly to the downside during the course of the week.

As we can see, there were a few potential trendlines that could have been drawn, however none were broken to the upside.

So, despite the fact that we were bullish, and completely wrong in that assessment, we end the week having lost nothing.

We can see here that by zooming down to a lower timeframe and waiting for a trendline break before trading, we managed to avoid taking any losses at all, because we didn't take any trades.

Let's just reflect for a moment on what we can learn from the above example. That we traded for two weeks and made no profits? No. The key takeaway here is that we identified a possible trade, which, if it was successful, had the potential to return a lot of pips. To put this in context, in the above example the distance that the market fell from the most recent highs to the reversal candle was 730 pips. What we managed to do was give ourselves the opportunity to

realise substantial profit but at very, very low risk. In this particular case, the realised losses were either very small or quite possibly zero.

By definition, because these trades that we are taking using this strategy target high reward, we do not get big winning trades every day. In fact, enduring a string of small losses or breakeven trades is a big part of the trading routine. Sometimes traders are too impatient or emotional to endure a period of time when their account equity is flat lining or declining slightly. They are still in the frame of mind of a “normal” job, i.e. I have sat at this computer for 9 hours, and now the market owes me my pay. For those of us who can see past this and be

a little bit more patient, the market holds significantly more potential.

There is nothing better than getting a nice tight entry at the bottom of a weekly swing, getting the risk taken off the table with the stop loss set to breakeven, and then just checking it maybe once a day for the next month, or even longer, as the weekly signal plays out and the profit steadily accumulates. To me, that is infinitely more appealing than sitting at a screen for 18 hours a day, trying to scalp a few pips here and there. Perhaps some of the readers here will agree with me.

Chapter Thirteen

The final part of the PAST Strategy is the most important. It has no charts, no examples, no technical analysis. It is about the difference between following a strategy and trading.

Readers might have noticed that throughout this book I have been quite vague when it comes to outlining strict criteria that tells us when to get in and out of the market. I don't dictate to you what a valid candlestick pattern looks like or tell you how to draw your trendlines. I don't specify how many pips to set your stop at or where you should take your profits. In truth, the

PAST Strategy can be summarised in a single sentence - look for a reversal on a long timeframe, enter on a trendline break on a shorter time frame, keep a tight stop and run the positions for as long as you can.

Some readers might have been slightly annoyed at this lack of clarity, but it is deliberate, and the book is written in this way for very good reason. We should realise that we are naturally inclined to go looking for the simple set of rules that we can just try to apply without having to think too much about what we are doing. The problem is that this approach is flawed, and you are fighting an uphill battle to achieve lasting success as a trader if you adopt it. Hopefully I can go

some way now towards explaining why.

If you are looking for something that tells you exact criteria about how to get into the market and when to get out, you are still blindly following a trading strategy.

You have yet to make the jump to becoming a **trader**.

Why is it that when people read about a strategy on a forum, or buy one from a trading system vendor, and they decide to use it - it rarely ever seems to work out for them? They get a period of drawdown, they lose faith, they start to tinker, it gets worse and then they give up. They dismiss the strategy as unprofitable and the person who devised

it as a nefarious scam artist. They move on to the next forum thread, looking for the next set of rules that they are going to try to adhere to. And the cycle continues. For some traders this pattern can last a very long time during which they make little or no progress in the markets.

Similarly, why is it that you have people who are very experienced in the markets, they know their technical analysis or fundamental analysis backwards, but yet still can't manage to make a profit?

Throughout this book I have tried to repeatedly stress the importance of the relationship between risk and reward in your trading. Proper traders aren't

people who blindly follow technical rules or systems to trade the markets. They are risk managers who use technicals or their strategy rules as their tools to define and control risk and target reward.

In the PAST Strategy I have introduced you to a good framework of technical tools within which you can control your risk and stretch out your reward. But candlesticks and trendlines won't make you profitable by themselves. Neither will moving averages, stochastics or anything else. Giving a technical system to someone who doesn't understand the role of risk management in trading is the same as taking a stranger off the street, giving him or her a hammer, saw and a

chisel and telling them to go and knock up a set of stairs. They have the correct tools, but unless they know what they are doing with them, it is simply not going to work.

The best trader is not the one who can recite the last 12 months Non Farm Payroll figures or sit at a screen for 24 hours straight. He's not the one who can draw the most beautiful trendlines or invent a new fancy indicator. The best trader is the one who consistently, day in, day out, controls his risk in the market and takes maximum advantage of the good opportunities when they present themselves to him.

The first step to successful trading is to

understand your goals in the market and then to understand the tools you intend to use to achieve them. It doesn't really matter whether the candlestick pattern was spot-on perfect, or that the trendline was drawn at the wrong angle. What matters is that you are **trading** - if you are doing that well, you will see the gains, sooner or later.

Chapter Fourteen

There are a few thoughts that I'd like to leave you with before I wrap this book up. As I have suggested throughout, there is a lot more to trading than entering when this crosses that. In fact, if I were to rank in order of importance skills that I think people who want to be successful traders should develop, the order would probably be something like this:

1. An understanding of the importance of risk and reward in trading
2. Everything in this chapter
3. Technical analysis (or fundamental analysis, sentiment analysis, anything

else really)

It's funny how if you were to measure the amount of material available to novice traders in terms of content, the order of the above list would probably be in reverse. I'm pretty sure there is a lesson to be learnt in there somewhere.

Expectations

No-one wants to talk about realistic expectations. The retail trading industry is built on selling dreams to investors. Realistic expectations don't really sell that well.

What do you really expect to achieve from your trading? Think about it honestly for a few moments. We can all

say what we would like to get from trading, but what do we expect to get?

What really are the chances of any of us reading a trading book over a weekend and then turning a thousand pounds into ten million pounds in a year. Not impossible, obviously, but let's face it, it is unlikely. And if we are going to do it, is it really going to happen with us spending no more than 15 minutes a day in front of the computer in our pants? It's like the lottery; the chance is undeniably there, but it is very, very small.

What is a realistic expectation then? With a bit of work and patience, could we learn a skill that we can have for the rest of our lives, that we can use to make

a solid few % return on average - month after month, year after year? You bet it is. Absolutely possible.

Let's start by growing a trading account by a few % month on month consistently for a while first, then we can think about the yachts. It's a marathon, not a sprint.

Losses

Everyone hates losses. They hurt, they really do. The last thing anyone wants to see is a stop loss getting triggered. It's like a little piece of you dies. Nassim Taleb reckons that a loss has a negative impact on us that is significantly greater than the positive impact we derive from a win of an identical size. Traders will

go to all sorts of lengths to avoid the pain of taking losses, often with pretty catastrophic consequences. Take any of the famous rogue trading scandals as an example – the dislike of losses is not just confined to retail traders, the big boys feel it too.

The first thing to do is to accept that losses happen in trading. We have already discussed this in a previous chapter. Rather than running away from them or trying to avoid them, we should be ready for them when they come and set about dealing with them in a way that will control and mitigate their impact.

I personally like to put losses in a context that helps me look at them more

objectively. I view them as a simple cost of business. If you opened a sweet shop you would have to pay rent, rates, salaries, stock, insurance, energy, etc., before you can sell your goods and return a profit. Any business endeavour will come with costs, and personal trading is no different.

Shop or trading, it doesn't matter - you keep a track of your expenses, and provided that you are responsible, disciplined and follow your strategy, you can expect to return a profit over time.

On the flipside of this, a sweet shop owner who pays his cleaner a hundred grand a year, turns up to work drunk and eats half his stock is unlikely to return

much of a profit. The same applies to your trading business.

Emotional Capital

The idea of emotional capital ties in nicely with the paragraph on losses above. As traders we all have an account with our broker in which we hold our capital. We use this capital to speculate in the markets. It is limited – if it runs out, we can't trade. But each of us also has an account in our minds in which we hold our emotional capital. Just as we are always interested in what our account balance is with our broker, we need to remain mindful of the balance in our emotional capital account too.

Our emotional capital is running low if the size of the loss, or indeed gain, that we stand to realise in the markets is large enough to affect our decision-making. This varies for everyone and so there can be no clear one-size-fits-all rule. Some trading gurus will advise - “never risk more than 5% of your account on a single trade”. This is plainly rubbish, because it assumes that the level of loss or gain, either in percentage terms or indeed cash terms, has the same effect on everyone.

For some people, carrying a 40% drawdown might not affect them at all, they are still thinking clearly and implementing their trading strategy with discipline. They have a large emotional

capital account. Other people could be an emotional or indeed physical wreck at the thought at carrying even a 5% drawdown. If they found themselves in such a situation they could be engaging in all sorts of destructive activity - doubling lot sizes, martingale, sleepless nights, running losing trades, breaking rules, etc. They are getting a margin call in their emotional capital account - when that happens, a margin call in the cash account often follows soon after.

The person who is emotionally capable of dealing with larger risk is not necessarily a better trader than one who prefers to keep risk small. They just will have different styles. The key is to be able to realise when we might be

beginning to stray out of our comfort zone and have the discipline to take the appropriate steps to bring ourselves back inside.

If you feel that you are getting angry or emotional at the market, you should simply lower your position size, lower the leverage. It can always be increased again at a later stage if you are feeling more comfortable. What's great about trading is that it is possible to get in and out of the market at the drop of a hat - it's no big deal. Or close the platform and take a break for a few days if you need to. The market will still be there next week, but your account might not. Do whatever you need to do to preserve it.

What's the biggest obstacle standing between us and consistently profitable trading? The trendline we drew that was slightly off? That the candlestick pattern wasn't "valid"? No, the big damage gets done when we lose control of our emotions and start to trade in a reckless and destructive way. We need to take all the precautions we can to ensure we keep our emotions in check.

Leverage

You have probably read about how leverage is a double-edged sword, increases your profits, but also your losses, etc., a million times. I know I have.

The use of leverage does increase the size of your profits and the size of your losses. In that respect, it is usually presented as a benign force, i.e. potentially good and potentially bad in equal measure. However I'd just like to draw your attention to a couple of points that are rarely discussed:

When you leverage your account you leverage your emotions too. The use of big leverage will magnify those potentially destructive emotions that we talked about in the previous paragraph and we need to be mindful of this. If your equity curve is jumping around, 30% down, swinging to 100% up, back to 70% down, the chances of you losing your discipline some day and blowing

your account are increased, exponentially. If you are using sizeable leverage and putting a chunk of your account on the line, watch how you are feeling like a hawk. If the palms are getting sweaty and the heart is beating fast, you are over extending yourself. You are not trading; (i.e. controlling risk) you are gambling. And if you want to gamble, I can think of way better places to do it than in front of a laptop by yourself at home. At least go somewhere where you can get a few free drinks or sandwiches while you lose your money (yes, I am talking about the casino!).

The second topic that I rarely see included in discussions about leverage

is that of transaction costs. The leverage multiplies the size of the winners, it multiplies the size of the losers, and it also multiplies the amount of money you pay to your broker every time you enter a trade, the spread. This is one of the reasons why brokers love seeing traders coming to trade at 200:1 leverage, it vastly increases their cashflow. The brokers don't care if the trader is successful or not, they will have any risk well hedged. Traders rarely do the sums on this - I would encourage you to work it out - how much per month do you have to make just to cover average transaction costs? 50:1 leverage in the retail forex world would often be considered to be quite responsible, so what about 50:1

leverage, 20 trades per month, with a 2 pip spread – sounds reasonable?

A simple, rough calculation would be as follows:

If you have a \$1,000 account and are leveraged 50:1, you will be controlling \$50,000, ($\$1,000 * 50 = \$50,000$) or 5 mini lots. A mini lot pip is usually worth about \$1, although this can change depending on the currency pair being traded.

If your spread is 2 pips and you trade 20 times per month, your total transaction costs will be $2 \text{ pips} * 20 \text{ trades} * 5 \text{ lots} = \200 .

\$200, or 20% of your capital, will be

spent just on transaction costs! Can you return 20% per month, every month, and then make some profit on top of that? Now, this figure might fluctuate based on a variety of different factors, for instance if you close most of your trades in profit, you might not notice the cost, but the general point still stands - leveraged transaction costs can be enormous. We need to be aware of them.

Trading versus a conventional job

I'm aware that parts of this paragraph might be construed as conflicting with the principles mentioned in the sweet shop example above, but I think this is important so I am going to mention it anyway. People who start trading after

working elsewhere in a more conventional job will usually have a different mindset in relation to what work is and how it is applied to trading. In the conventional workplace, more effort expended, more time spent, is generally a good thing and we can reasonably expect to be rewarded for hard work.

This is not true in the trading sphere. Yes, work is required to learn how to trade, that much is true. But time spent in front of the screen actually trading does not necessarily positively correlate with trading profits. If anything I would suggest that the opposite is true; the more time you spend trading, the worse your results tend to be. This is difficult for

people to wrap their heads around sometimes; it goes against everything we are taught about working.

Sometimes the market on a particular day or week is simply not moving, or we are on the wrong side of the momentum, or whatever, it could be anything. Maybe we are tired or we have something else going on in life that is distracting us or affecting our concentration. These are the days that we need to step back. Our day's work is simply having the discipline to recognise that we are not on form and close down the screen. This can often be much, much harder to do than it is to put in a long day in your day job. The days that we spend trying to force pips out of a market that is not

playing ball with us are the days that we will realise the big, unnecessary losses. We need to control this downside risk.

Patience

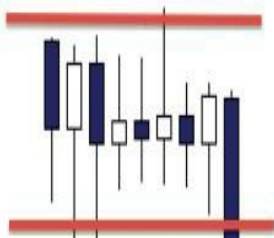
“It never was my thinking that made big money for me. It was always my sitting. Got that? My sitting tight!”

- Jesse Livermore

Patience is a tough one. The market, contrary to what many people think, moves far more slowly than we would like it to. The natural movement of the market is split between short bursts of movement and then longer, often frustrating, periods of ranges.

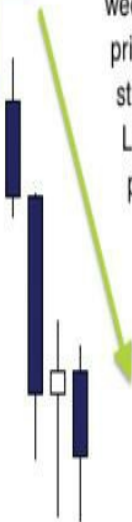
Part of the battle is to knowing to stay out of the market when it is not performing as we want, and having the patience to stay out until it is. Remember, the market does not exist to provide us with entertainment.

However, the good thing is that the market usually rewards patient traders with big moves:



Eight long weeks of tight, difficult trading conditions. Impatient traders are getting their accounts chopped to pieces!

Traders who were patient & waited for the range to break were rewarded - three straight weeks with price moving straight down. Lots of easy profit!



Recording and Measuring

“If you can’t measure it you probably can’t manage it - things you measure tend to improve.”

- Ed Seykota

I lost count of the number of times I read about the merits of keeping a diary or a record of my trades. I always thought that it sounded like a useful idea but I never really bothered to do it. Now however, having kept trading records, there is nothing that I know of in trading that will have such a positive impact on your performance in return for such little effort.

We measure so much in our day-to-day lives, it is inconceivable really that some people do not measure their trading performance. And by measure it I don't mean checking whether your profit and loss account is positive or negative, I mean keeping proper statistics and monitoring them regularly.

If you are going on a diet, you weigh yourself first and then periodically thereafter - that's how you know if you are making progress or not. Athletes measure all sorts of different things as they train, in an effort to identify something that could shave an extra precious second off their time. We measure our performance at school, college, or university by doing exams.

They are a benchmark against which to measure progress.

If we want to measure and improve our trading we need to keep good records. There are a variety of services available online now that will take the data generated from your trading directly from your broker and spit out all sorts of statistics for you automatically. If you don't want to link your account to one of these services for whatever reason, you are going to have to fire up your excel spreadsheet and start recording your trades.

Review these statistics regularly. I would recommend at least once a week. When the market is closed on the

weekend can be a good time to review performance. At the very least, you should know the size of your average winner, the size of your average loser and your percentage trade success rate off by heart. If you have your statistics in your head, your brain will process this information and implement it into your trading subconsciously. After reviewing your stats over a weekend you might notice that your average losing trade is getting a little bigger than it used to be. In response you will find that you will automatically start to be more careful with your entries, tighter with stops. You will be making all sorts of improvements without even realising it.

Perseverance and Determination

"All of old. Nothing else ever. Ever tried. Ever failed. No matter. Try again. Fail again. Fail better."

- Samuel Beckett

We all know the statistic that is quoted everywhere, that 95% of traders fail. Well, I have seen the alleged failure rate quoted as being as low as a 90%, and as high as 99%, so I suppose picking a figure somewhere near the middle is likely to be the fairest.

In any event, if accurate, a failure rate of anywhere north of 90% is a pretty daunting prospect for the aspiring trader.

I have a problem with this statistic, on a number of different fronts. I would like

to see a definition of the term “trader” to start with. Is someone who throws £100 into a spread betting account and loses it on a few £1 per point Forex bets really deserving of the term “trader”?

In addition, in order to fail at something, you must first try to succeed at it. What have these people done to attempt to actually succeed at trading? I’d also like to see what failure is defined as being, and while we’re at it, I’d like to see what success is defined as too.

If I pick up a tennis racket, try to hit a ball, miss, and put the racket down again, have I failed at tennis? Have I tried to succeed at tennis?

I am not saying that trading is easy; it certainly is not. But I don't think that the failure statistics sound accurate either. If you are to define a trader as someone who has actually taken the time and effort to really study and learn about the markets; and if you are to define success as them returning a consistent and sustainable profit over a certain period of time, I think the failure rate is a lot lower than 95%.

On the other hand, if a trader is someone who has read about financial markets on the internet for a weekend and then thrown some spare cash into a broker account; and success is defined as retired sitting on a yacht in the Med within a year, I wouldn't argue if you

suggested the failure rate was 100%.

Being good at anything worth being good at takes time, effort and dedication. You get out what you put in. Success in anything requires discipline, motivation, passion. If you decide to trade the market, it will test you, provoke you, punish you, reward you.

If you are prepared to **risk** the time and effort required to learn how to trade the markets, the potential for **reward** is limitless. Everything in life is a trade on one level or another.

Good luck with your **trading**.



Remember, as a member (it's completely FREE) of **Forex Useful** (<http://forexuseful.com/>), you will be able to download and print the 3 strategies in this book and you will also have access to:

- **Via our newsletter, FREE weekly updates on the Price Action**

Swing Trading (PAST) Strategy and all other strategies in this book

- **FREE Live market sessions
(usually every Monday morning)**



**As well as access to
the products, updates
and sessions you will
also be informed of
future book releases
including launch and
discount offers, before
anyone else!**

Next up, **Trading With Confluence – The Foundations** by "Forex" John...

Trading With Confluence – The Foundations

Trading With Confluence (TWC)



by
Forex
John

The Foundations

Introduction

As a trader with years of experience, I know that to trade consistently 365 days of the year, through the highs and lows, the ups and downs, and the sideways markets, you need a set of sound trading foundations.

Trading With Confluence (TWC) is an underutilised trading approach. Many ‘at home’ traders search for the Holy Grail, the system that promises millions or the one that “even a twelve year old can trade once a day”! Most (if not all) of you have been there.

Realistically though, as I have already said, all you really need is a set of sound

trading *foundations* to allow you to form a real time view of the market and a technical outlook (Trading plan). You don't need anything fancy, when you bring your foundations together and *Trade With Confluence* you will have a solid plan that will enable you to profit in all market conditions.

My foundations are split into 3 categories, Analysis (Pre-Entry), Trigger (Entry) and Awareness.



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Trading With Confluence (TWC) - The Foundations

Provided by
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and make money online!



ANALYSIS (PRE-ENTRY)

Daily
Pivots

Big Round
Numbers

ATR

Support &
Resistance

AWARENESS

News

Fibonacci
Retracements

Trend Lines

TRADING PLAN



TRIGGER (ENTRY)

Chart
Patterns

Stochastics

Divergence

Candlestick
Patterns

Bollinger
Bands

(TWC Daily
Analysis Reports)

Multiple
Time Frames
(MTFs)



The ‘Analysis’ foundations allow me to form a real time view of the market. When combined with the ‘Trigger’ and ‘Awareness’ foundations I am able to form a Trading plan AND a technical outlook of the market. This Trading plan is the core of my trading, my TWC Strategy and my TWC Daily Analysis reports, both of which are included in the [Trading With Confluence \(TWC\) Daily Analysis service](#) available exclusively at Forex Useful.

My foundations have stood the test of time and they are used in some form by ALL major trading institutions. In this book I aim to teach you my foundations and how I use them to Trade With

Confluence consistently and profitably in all market conditions.

My personal strike rate target is 80%+ and I always look for a Risk:Reward of at least 1:1 or higher on all my trades.

Confluence

***Confluence:** A gathering, flowing, or meeting together at one juncture or point*

Before we go any further, please take a moment to read this chapter in full.

Until you really KNOW what ***Trading With Confluence*** is all about, you won't be able to utilise it in your everyday trading.

We all know for a fact that the markets are made up of a variety of strategies that allow a trader to form an opinion and instigate a market order. We also know that these strategies offer that

specific trader an informed decision. One thing we all like is making an informed decision, whatever the circumstance in life!

Like the foundations of a building, the foundations of a market will allow you to give reason as to why the market does certain things and makes certain movements. A much underutilised approach is using these foundations in confluence.

Have you ever seen a market cut through Support or Resistance levels like butter? Have you ever seen a Chart pattern get broken like it was not even there? Now couple the Chart pattern with Support and Resistance, Trend lines, Daily

pivots, etc. Do we see anything different? YES we do, *Trading With Confluence is all about bringing foundations together*, allowing us to make a STRONGER more informed decision of where a market is likely to move.

Think of the financial markets as a 200ft building. What goes into keeping this building from blowing over in high winds? On a very basic level, the structure of the building starts with drawings, followed by the mathematics for weight and load bearing, the foundations, the internal structure and supports, required materials, etc., etc.

To become a consistent trader you need

to think in a similar way, you need to consider the before, the now and the after.

Trading With Confluence is about taking sound trading foundations and bringing them all together to create a Trading plan with much higher probability trading opportunities.

Looking at these aspects individually never gives you the ‘full’ market view. Bring them together, and, as you will see, you start to see the real reason behind market movements.

Do not get caught up in looking for a ‘perfect set up’ but do be aware that good moves (profitable ones) will

almost always occur when there are multiple trading foundations working in confluence across multiple timeframes.

I hope you enjoy the book.

Foundations - Introduction

As mentioned above my foundations are split into 3 categories:

- Analysis (Pre-Entry),
- Trigger (Entry) and
- Awareness

My 'Analysis' consists of the following foundations and mainly assists me in forming a real time view of the market:

1 – Support & Resistance,

2 – Fibonacci Retracements,

3 – Trend Lines,

4 – Daily Pivots,

5 – Big Round Numbers and

6 – ATR

My ‘Entry’ consists of the following foundations and mainly assists me in forming a Trading plan (a technical outlook of the market).

7 – Chart Patterns,

8 – Candlestick Patterns,

9 – Stochastics,

10 – Bollinger Bands and

11 – Divergence

‘Awareness’ assists in both stages as I

incorporate:

12 – News and

13 – Multiple Time Frames (MTFs)

Foundations - Overview



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Trading With Confluence (TWC) - The Foundations



ANALYSIS (PRE-ENTRY)

Support &
Resistance

Daily
Pivots

Big Round
Numbers

ATR

AWARENESS

News

Fibonacci
Retracements

Trend Lines

TRADING PLAN

TRIGGER (ENTRY)

Chart
Patterns

Stochastics

Divergence

Candlestick
Patterns

Bollinger
Bands

(TWC Daily
Analysis Reports)

Multiple
Time Frames
(MTFs)



The resulting **TRADING PLAN** is the core of my trading, my TWC Strategy and my TWC Daily Analysis reports.

Foundations – Analysis (Pre-Entry)

The ‘Analysis’ consists of the following foundations:

- 1 – Support & Resistance,
- 2 – Fibonacci Retracements,
- 3 – Trend Lines,
- 4 – Daily Pivots,
- 5 – Big Round Numbers and
- 6 – ATR

These foundations mainly assist me in forming a real time view of the market. I will work through these foundations by

building on an example chart, one where I create the ideal *Trading With Confluence* environment, simply to aid the ‘teaching’ process.

LET’S START WITH THE ‘NAKED’ CHART



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Confluence**



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1 – Support & Resistance

I sometimes simply refer to this as SR and this is where it all starts. From the morning analysis to the trade entry, everything revolves around Support & Resistance. This is what the big banks and institutions refer to as 'value'. Support & Resistance is where a specific market is given a value and a risk (long or short). Depending on where this value is placed, will be where we often see Support & Resistance levels and zones.



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Here we can see that the 1.4000 level was Resistance (no less than 5 times) on the way up and has, since broken, provided Support. This is often the case, as the saying goes, previous Resistance often becomes Support and vice versa.

2 – Fibonacci Retracements

Fibonacci retracements form part of the 'market cycle'. From the monthly down to the 1 minute timeframe you will find Fibonacci retracements everywhere. All Fibonacci retracements from 23.6%, 38.2%, 50%, 61.8% are valid levels that I use to derive areas of potential Support & Resistance.



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Confluence – Here we can see that the 50% Fibonacci retracement level at 1.3999 ties in with the Support & Resistance level at 1.4000.

3 – Trend Lines

I use Trend lines across Multiple Time Frames to generate an opinion on market direction, both immediate and long term. I use them to once again identify areas of Support & Resistance, where the market may reverse.



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Confluence – Here we can see that the Trend line is looking at providing some form of support anywhere from the area 1.3985 to 1.4020. Depending on timing it could tie in with the 50% Fibonacci retracement level at 1.3999 and the Support & Resistance level at 1.4000.

Looking at this from a ‘confluence’ state of mind, we can already see SUPPORT

LEVELS work in tandem with a trend line. Trading With Confluence anyone?

4 – Daily Pivots

The Daily pivot (PP) will consistently offer a level of interest for me. I do not only use it to judge current market sentiment and direction, but to also identify potential ‘bounce’ areas. I also observe the associated Daily Pivot Support and Resistance levels 1, 2 and 3.



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Confluence – Here we can see that the Daily Pivot Support 1 (S1) level at 1.3997 ties in with the 50% Fibonacci retracement level at 1.3999 and the Support & Resistance level at 1.4000. It could also, depending on timing, tie in with our Trend line.

5 – Big Round Numbers

Markets will often ‘respect’ Big Round Numbers (BRNs), e.g. 1.6700, 0.9000, etc. Often the more zero’s they have the more respect they command. Thus 0.9000 will command more respect than 1.2300.

These Big Round Numbers often provide some form of Support & Resistance.



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Confluence – By coincidence the Big Round Number (BRN) on our chart ties in with the Daily Pivot Support 1 (S1) level at 1.3997, the 50% Fibonacci retracement level at 1.3999 and the Support & Resistance level at 1.4000. It could also, depending on timing, tie in with our Trend line.

6 – ATR

ATR stands for Average True Range and it is a much underutilised foundation that many people fail to acknowledge.

Let's say someone told you that there is a great pre-trading way to identify an expected market movement in PIPs, you would think they are crazy! Well, with ATR you get exactly that. I personally use the past 10 days trading period and take the average movement of the market during this number of days. This gives me a fair indication of how far I can expect the market to move today.

When used in confluence with other foundations the ATR can really help me

identify key reversals in the markets (where it may become exhausted).

See additional example at the end of this book.

Analysis (Pre-Entry)

Foundations Summary

We just covered the following foundations:

- 1 – Support & Resistance,
- 2 – Fibonacci Retracements,
- 3 – Trend Lines,
- 4 – Daily Pivots,
- 5 – Big Round Numbers and
- 6 – ATR

As you can see by starting with Support & Resistance and working our way through the other foundations we are

able to quickly and effectively form a real time view of this market. This allows us, by using confluence, to identify potential areas of Support & Resistance (zones) for potential trade entries.

Foundations – Trigger (Entry)

The ‘Trigger’ consists of the following foundations:

7 – Chart Patterns,

8 – Candlestick Patterns,

9 – Stochastics,

10 – Bollinger Bands and

11 – Divergence

These foundations mainly assist me in forming a Trading plan (a technical outlook of the market).

Once again I will work through these

foundations by building on the example chart from before, where we have created the ideal *Trading With Confluence* environment, simply to aid the ‘teaching’ process.

Price has now been rolled forward so that we can observe the ‘Trigger’ foundations in action.

7 – Chart Patterns

A ‘Double top’ and a ‘Double bottom’ are the primary chart patterns I focus on. Both provide a clue to potential market rejection areas. They are simple to spot and they are leading indicators, so provide a strong weighting for both analysis and potential trade entries.



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Here we can see the ‘Double bottom’ Chart pattern.

Note: If you do have a good knowledge of further chart patterns, then please include these into your own trading, as they will certainly not hinder you.

8 – Candlestick Patterns

Despite there being a number of candlestick patterns, I have refined my knowledge to focus on a Hammer (bullish move), and a Shooting star (bearish move) as key signals for market direction. Candlesticks are used for both immediate direction and for potential entries. Longer timeframes often provide more reliable signals.



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Here we can see the ‘Hammer’
Candlestick pattern.

9 – Stochastics

There are many indicators out there but my personal preference, after using them for over 10 years, is to use Stochastics and Bollinger Bands (see the next section). However, any that suit YOU as a trader can be used so long as you look to use them in confluence with other foundations.

I use Stochastics (and Bollinger Bands) to determine potential reversal areas in the market. Stochastics (and Bollinger Bands) were developed to identify pivot points in the market, as well as areas for potential expansion. They offer a quick visual of what the market has been and is

currently doing. For both analysis and live trading, for me, these are crucial tools.



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OVERSOLD



Here we can see the Stochastic in 'Oversold' territory indicating a potential reversal area in the market.

I use the Stochastic settings (14,5,2) and consider Oversold being less than 20 and Overbought as greater than 80.

10 –Bollinger Bands

As mentioned above, Bollinger Bands is the other indicator I use to determine potential reversal areas in the market, by observing price in relation to the Upper/Lower bands.



Here we can see the Lower Bollinger band has been pierced indicating a potential reversal area in the market.

I use the Bollinger Band settings (18, 2).

11 – Divergence

The last foundation I consider is divergence. Divergence provides an indication that price and an indicator (I use Stochastics as they are already on my chart) are out of sync thus there is potential for a correction in the market.



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Here we can see an example of “hidden bullish divergence”.

Trigger (Entry) Foundations Summary

We just covered the following foundations:

7 – Chart Patterns,

8 – Candlestick Patterns,

9 – Stochastics,

10 – Bollinger Bands and

11 – Divergence

Being aware of and applying these foundations in *confluence* means:

- We can form a technical outlook of

the market,

- Anticipate potential entries and
- Verify them in real-time as and when they ‘trigger’

As we have created the ideal *Trading With Confluence* environment, simply to aid the ‘teaching’ process, here we can see all the ‘Trigger’ foundations coming together.



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Foundations - Awareness

‘Awareness’ assists in both stages as I incorporate:

12 – News and

13 – Multiple Time Frames (MTFs)

Into my plan.

12 – News

Just view NFP (Non Farm employment figures) on the first Friday of every month and you will see why NEWS is something which should always be considered. Here we can see Support & Resistance having no meaning during this news announcement (a 100 PIP move). Please also note that the Big Round Number was ‘ignored’ by the market too, no time to Trade With Confluence!



Trading With
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My personal opinion is to avoid trading around high impact NEWS areas (at least half an hour either side). That said, I do use NEWS to prepare for potential momentum that it can bring to the market.

I always comment on News in my Trading plan and include reference to it in the TWC Daily Analysis report.

13 – Multiple Time-Frames (MTFs)

Trading With Confluence would be incomplete without including MTF analysis. A simple glance across multiple time frames (I use 3) offers a completely different, in depth market profile.

Think of a single timeframe like a 1mp camera or simply an old style webcam. Pictures are pixelated with little colour and sharpness. Now add in other time frames (the latest digital DLR 20mp camera) and we see things we couldn't dream of seeing across that single time frame. Couple market foundations across

multiple time frames and we get high probability trades, time after time.

I pay consideration to the following foundations on the Daily, 4 Hour and 1

Hour timeframes as indicated:

- 1 – Support & Resistance (ALL)
- 2 – Fibonacci Retracements (ALL)
- 3 – Trend Lines (ALL)
- 4 – Daily Pivots (1 hour)
- 5 – Big Round Numbers (1 hour)
- 6 – ATR (1 hour)
- 7 – Chart Patterns (ALL)

8 – Candlestick Patterns (ALL)

9 – Stochastics (ALL)

10 – Bollinger Bands (ALL)

11 – Divergence (ALL)

Looking at these foundations individually or any timeframe individually never gives you the ‘full’ market view. But, bring them together, and, as you will see, you start to see the real reason behind market movements.

Remember: Do not get caught up in looking for a ‘perfect set up’ but do be aware that good moves (profitable ones) will almost always occur when there are multiple trading foundations

working in confluence across multiple timeframes.

I often comment on MTFs in my Trading plan and include reference to them in the TWC Daily Analysis report.

It All Came Together

Obviously, as mentioned above I created the ideal *Trading With Confluence* environment, simply to aid the ‘teaching’ process. This is how it all came together.



See how we used confluence. Our ‘*Analysis*’ included the confluence of our *Support & Resistance, Fibonacci Retracement, Trend Line, Daily Pivot* and *Big Round Number* foundations. Our ‘*Entry*’ included the confluence of our *Chart Pattern, Candlestick Pattern, Stochastic, Bollinger Band* and *Divergence* foundations.

Of course in the real world we would also have paid attention to our ‘*Awareness*’ foundations, *News* and *Multiple Time Frames (MTFs)*.

Note: On trades like this my typical Stop loss is about 10 – 20 PIPs and my typical Target is 20 – 30 PIPs, aiming

for a usual 1:1.5 Risk:Reward trade profile.

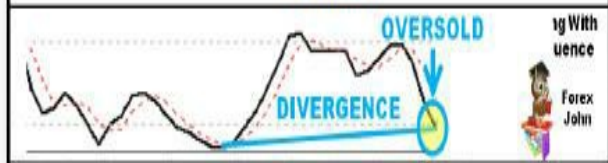
Additional Example

In this example we see a different kind of reversal and a different set of foundations making up our confluence.

Our '*Analysis*' this time includes the confluence of our *Daily Pivot (at S2 (0.8905))*, *Big Round Number (at 0.8900)* and *ATR (extension) (at 0.8902)* foundations.



Our '*Entry*' this time includes the confluence of our *Candlestick Pattern*, *Stochastic*, *Bollinger Band* and *Divergence* foundations.

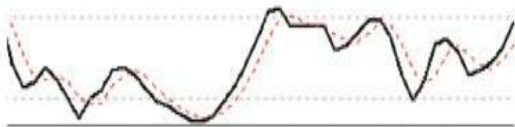


And, here is how it all came together.

Trading With Confluence



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Once again, I will mention that in the real world we would also have paid attention to our '*Awareness*' foundations, *News* and *Multiple Time Frames (MTFs)*.

Note: Also, with trades like this, again, my typical Stop loss is about 10 – 20

PIPs and my typical Target is 20 – 30 PIPs, aiming for a usual 1:1.5 Risk:Reward trade profile.



Remember, as a member (it's completely FREE) of **Forex Useful** (**<http://forexuseful.com/>**), you will be able to download and print the 3 strategies in this book and you will also have access to:

- **Via our newsletter, FREE weekly updates on the Trading With**

Confluence Strategy and all other strategies in this book

- **FREE Live market sessions (usually every Monday morning)**



As well as access to the products, updates and sessions you will also be informed of future book releases including launch and discount offers, before anyone else!

To understand and implement the strategies defined in this book obviously requires at least some basic knowledge of Forex and Currency Trading. Those new or even relatively new to trading may find my book **Forex For Beginners – An Illustrated Introduction To Currency Trading** of interest.

Those of you considering trading Binary Options you may also find my other book **Binary Options – A Strategy Guaranteed To Beat The Brokers In 15 Minutes Flat**, of interest.

I really hope you enjoy this book and if you do then please do take the time to leave a review, it takes less than a minute and your feedback is personally

appreciated by me.

Jon McFarlane

Forex Useful

(<http://forexuseful.com/>)

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